SUPPLEMENT TO

WORLD ECONOMIC SURVEY 1985-1986

- International monetary reform and the socialist countries
- The changing institutional character of international financial markets in the 1980s
- Countertrade in developing countries
- Problems and policies of countries affected by desertification and drought

ST/ESA/188

Department of International Economic and Social Affairs

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PREFACE

The 1985-1986 Supplement to the World Economic Survey comprises four studies. The first, "International monetary reform and the socialist countries", consists of a systematic review of official and indirect sources of information concerning the views of the socialist countries on some key issues of monetary reform, based on material available up to 1985.

"The changing institutional character of international financial markets in the 1980s" explores changes in financial markets and their implications for credit access, stability of capital flows, and the functioning of domestic macro-economic policies. The rise in the "securitization" of financial markets, together with the increasing recourse to low-risk borrowers, is an important trend which might lead to the exclusion from the market of those developing countries that have difficulties in debt payments even after current debt problems are resolved. Potential improvements in access to credit through innovative market mechanisms are also discussed in the study.

Inadequate access to credit and liquidity is one of the principal reasons for the recent surge in countertrade. "Countertrade in developing countries" reviews the different manifestations of countertrade as an important dimension of economic co-operation among developing countries and between developing and industrial countries as well. The study addresses the question of whether countertrade is simply a temporary expedient linked to current economic problems or a permanent and growing feature of international trade.

While the proper functioning of the money, finance and trade nexus is of great importance to the world, the soundness of the ecological system is no less important. In this regard, the process of desertification and drought has been particularly serious. "Problems and policies of countries affected by desertification and drought" has been included in the present Supplement in compliance with General Assembly resolutions 39/208 of 17 December 1984 and 40/175 of 17 December 1985. The study notes that national and regional or subregional efforts are indispensable to halting desertification and beginning a slow process of renewal. In the final analysis, however, desertification is a global responsibility that requires a global response.

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EXPLANATORY NOTES

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

Reference to "dollars" ($) indicates United States dollars, unless otherwise stated.

Reference to "tons" indicates metric tons, unless otherwise stated.

The term "billion" signifies a thousand million.

A hyphen (-) between years, e.g., 1984-1985, indicates the full period involved, including the beginning and end years; a slash (/) indicates a financial year, school year or crop year, e.g., 1984/85.

A point (.) is used to indicate decimals.

The following symbols have been used in the tables:

A dash (--) indicates that the amount is nil or negligible.

A minus sign (-) before a number indicates a deficit or decrease, except as indicated.

Details and percentages in tables do not necessarily add to totals because of rounding.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

For analytical purposes, the following country classification has been used:

Centrally planned economies:	China, Eastern Europe and Union of Soviet Socialist Republics
Developed market economies:	North America, southern and western Europe (excluding Cyprus, Malta and Yugoslavia), Australia, Japan, New Zealand and South Africa
Developing countries:	Latin America and the Caribbean area, Africa (other than South Africa), Asia (excluding China and Japan) and Cyprus, Malta and Yugoslavia

INTERNATIONAL MONETARY REFORM AND THE SOCIALIST COUNTRIES

CONTENTS

INTRODUCTION

The centrality of the monetary and financial system and the general perception that it is malfunctioning have generated official reports on reform by the Group of Ten, the Group of Twenty-Four, the Movement of Non-aligned Countries and the Commonwealth Secretariat. The centrally planned economies, as a group, have not endorsed a comparable report in recent years. Their policy stance must be derived, therefore, from several complementary sources. Key considerations are (a) the experience of the socialist countries with the existing official financial institutions and arrangements; (b) the critique of the Bretton Woods system and its evolution elaborated by a number of those countries since the early 1970s; (c) the more general positions of those countries on the new international economic order; and (d) their recent stance on specific North-South economic relations. There are few examples, however, of a common platform on the international monetary system endorsed by these countries.

Policy positions on economic matters are rarely adopted explicitly by all socialist countries. In fact, the group has not taken a common stance on the international monetary system since the late 1950s. This is due in part to the absence of some socialist countries from institutions and groupings that make policy statements, 1/ and to the fact that there is considerable variation in levels of development within the group of socialist countries, hence their substantively different interests on this issue. In short, there is no recent uniform, formal policy stance on past, present or future international monetary systems that could be unambiguously classified as a common statement on behalf of all socialist countries.

A problem related to the identification of policy positions on matters of relevance to possible reform of the international monetary system is that it is not at all easy to assess where some large socialist countries stand on important international economic, monetary and financial issues. This is particularly the case of China, which has participated actively in global economic and financial affairs only since the mid-1970s. In addition, China's socio-political and economic priorities since 1978 have centred on restructuring its domestic economy through administrative reforms, on reducing the gap between its level of development and that attained by developed countries and, indeed, on effecting

economic modernization as but one aspect of the perceived need to modernize Chinese society more generally. Moreover, China considers itself "part of the third world". 2/ This is reflected in its support of many of the positions held by the Group of 77, even though it is not a member of that group. As far as fundamental principles are concerned, however, the position of China does not diverge markedly from that of the majority of the socialist countries. 3/

In preparing an overview of the recent policy stances, it is important to sketch the evolution of the official policy of socialist countries on and their attitudes towards international monetary institutions and the Bretton Woods system in particular. This is done in the following section. The key systemic features of centrally planned economies that may determine the circumstances in which these countries might participate more fully in the international monetary system are then discussed. The final section contains a summary of elements of a modified or reformed international monetary system that socialist countries might advocate in eventual reform of the international monetary system and how they might participate in such a modified system.

The starting point in the present analysis is that fuller integration of socialist countries in the international economic and financial fabric implies, at least potentially, enlarged participation in the international institutional infrastructure, including official multilateral monetary institutions. Since this may require important changes in attitudes, and possibly in the organizations themselves, the prospective development of the appropriate international relations needs to be seen as a dynamic process that is occasionally modified by evolving domestic and international events.

THE SOCIALIST COUNTRIES AND BRETTON WOODS

The present section reflects the views held by the majority of the European centrally planned economies. The analysis is based on official pronouncements on the international monetary system and an assessment of the attitudes of those countries towards eventual reform of the Bretton Woods system, their experiences with the International Monetary Fund (IMF) and the World Bank in the early post-war years, and more general attitudes on essential aspects of an international monetary system.

Post-war experiences with the International Monetary Fund

The post-war involvement of States members of the Council for Mutual Economic Assistance (CMEA) with the world's monetary system can be divided into four phases: the protracted negotiations that eventually led to the establishment of the Bretton Woods system; the severing of most international relations outside the CMEA framework; the exploration of ways of joining IMF and the World Bank; and the experience of socialist countries that have participated or currently participate in these multilateral institutions.

Several of the present socialist countries were actively engaged in the preparation, and even in the early activities, of the Bretton Woods system. The Union of Soviet Socialist Republics, which at the time was the only socialist country apart from Mongolia, was especially involved in the deliberations that led up to the creation of IMF. In fact, several of the Fund's articles were drafted with a view to assuaging Soviet concerns, and the USSR gave the impression for several years that it would definitely be one of the founders. 4/

The principal concerns voiced by the USSR during 1943-1944 were that (a) the USSR quota as proposed by the United States of America was too small; (b) the gold share of the quota should be reduced from 25 per cent to 15 per cent of the quota for all members, and even to 7.5 per cent for the then "occupied countries"; (c) the exchange rate of the rouble should not be controlled by the Fund since it did not affect the competitive position of other countries; (d) roubles made available for drawings from the Fund should be used only for purchases from the USSR; (e) the USSR should not provide more economic information than was mutually agreed upon between that country and the Fund; (f) newly mined gold should not be used for repurchases of the members' own currencies from the Fund; (g) the USSR should have sufficient voting power to be able to veto a uniform change in the par value of the currencies of the member countries - hence the price of gold; and (h) members should not be obliged to heed the Fund's views on any existing or proposed monetary or economic policy. The USSR also objected to the deposit of the gold tranche for storage in the United States. This comprehensive list of proposals for amending the draft Articles of Agreement could have deterred the USSR from joining. Nevertheless, it continued to participate actively in the shaping of the new institutions and thus kept its option of membership open.

In the debates about the fundamental aims and prerogatives of the global institutions, the USSR tended to favour the Keynes Plan over the White Plan; the latter plan was adopted with some modifications. It is interesting to recall that the regional monetary unit (the transferable rouble) and the settlements bank (the International Bank for Economic Co-operation) of the CMEA countries, which were established in 1964, embody important ingredients of the Keynes Plan. Some of the basic elements of that Plan, however, including symmetry in the penalization of chronic debtors and creditors, pure "ideal credit money" as the system's reserve and global control over liquidity creation, were not embodied in the CMEA clearing mechanism. In 1943-1944, however, it remained unclear whether the USSR was basically negotiating about the creation of a settlements organ. 5/ There are several indicators that suggest that the USSR may have visualized the proposed organization as one more akin to a development institution than to one preoccupied with balance-of-payments and stabilization measures. 6/

At a preparatory conference at Atlantic City in June 1944, several of the USSR's concerns were aired and were apparently satisfactorily resolved. For instance, the quota for the USSR was increased to 14 per cent; France supported the Soviet view on gold subscriptions; a compromise was reached on the question of information to be submitted and on exchange rate monitoring of members whose exchange rate adjustments did not affect the international transactions of other countries; and a satisfactory resolution of the problem concerning the deposit of gold was also found. These compromises were incorporated into the draft Articles of Agreement, which were signed at Bretton Woods; in signing them, the Soviet delegation had neither written nor oral reservations. 7/ But the USSR never ratified the Agreement. The arguments raised during the negotiations and the key objections to the Bretton Woods system, which were formalized at a later date, will be examined in more detail below.

Although the Soviet Union never formally refused to join the Fund it abstained from participating in its affairs after the first Governors' meeting at Savannah, Georgia, in March 1946. The Soviet delegation, which attended the meeting as an observer, argued that membership was pending but that more time was required to study the matter. For economic and political reasons, the USSR has not contacted the Fund since that time.

China, Cuba, Czechoslovakia, Laos (now the Lao People's Democratic Republic), Poland, Viet Nam and Yugoslavia were also among the Fund's early members. Some were even founders. With a few exceptions, however, they were not members for long. Poland resigned in March 1950 alleging that the Fund had failed in its original purpose as it had become subservient to United States interests. 8/ Poland apparently approached the Fund in October 1956, 9/ but the Fund made it politically impossible for that country to contemplate membership seriously. 10/ Czechoslovakia remained in the Fund until the end of 1954 when expulsion was recommended by the Executive Directors, but decided to resign voluntarily in May 1955. The formal problem was that Czechoslovakia had not consulted with the Fund about the June 1953 devaluation of the koruna and the accompanying monetary reform, and that it had refused to provide information and co-operation. In the case of the People's Republic of China, after it was established in October 1949, it did not seek its chair, which was held by the Republic of China, until the early 1970s. Prior to its own resignation, Czechoslovakia had acted on behalf of the People's Republic of China in seeking the expulsion of the Republic of China.

Cuba withdrew from the Fund in 1964 partly because it could not meet its financial obligations and partly because of the far-reaching political changes since the late 1950s. Yugoslavia, however, has been a member from the early days of the Fund. The Socialist Republic of Viet Nam assumed the membership obligations of the Republic of Viet Nam after reunification. Albania and Bulgaria made tentative inquiries in 1948, but did not follow them up. On the occasion of the first session of the United Nations Conference on Trade and Development (UNCTAD) in 1964, both Hungary and Romania held exploratory talks with IMF representatives, but there was no follow-up. 11/

Why was the participation of socialist countries in the Bretton Woods institutions during this second phase so negative? In order to understand the reaction of the socialist countries, it is useful to look briefly at the objectives of the Fund and the Bank and the possible interests of the socialist countries in the technical aspects of the Bretton Woods system. There are chiefly two sets of reasons why these countries chose not to participate.

One was the cold war and its adverse effects on international relations. These political factors were undoubtedly the main reason for the negative attitude of the socialist countries towards the Fund. At the time of the first Governors' meeting, Winston Churchill had just delivered a speech at Fulton, Missouri (5 March 1946), apparently with the tacit approval of President Truman. This speech is better known for its coinage of the term the "Iron Curtain" than for its chilling presumptions of dominance by the "English-speaking peoples" in world affairs under the nuclear umbrella that "God had willed to the United States"; Churchill also advocated "a unity in Europe from which no nation should be permanently outcast". 12/ This and similar rhetoric, however, did not reassure the Soviet Union; the spirit of co-operation that had prevailed within the wartime alliance was quickly evaporating. Under the circumstances, the USSR may have felt that there was no point in pursuing membership in the Fund. Czechoslovakia and Poland, which were not socialist countries when they joined, withdrew eventually for political reasons. 13/ Similarly, Cuba withdrew in 1964, as a consequence of the revolution in that country and the economic and other societal changes of the early 1960s. In this respect, the socialist countries had a common motivation in severing nearly all formal and informal ties with international economic, financial and other organizations in which East and West participated.

This second phase in post-war international economic relations lasted for about 20 years for some socialist countries; it continues for others, at least

inasmuch as full participation in some crucial international organizations is concerned. Two circumstances are important in explaining why joining the Bretton Woods system came to the fore, although at first hesitantly, in the policy discussions of some socialist countries as early as the second half of the 1950s. First, the gradual easing of tensions between East and West led to greater dynamism in interregional trade and finance. This required fuller involvement in the global trading and financial networks. Secondly, the more congenial disposition of socialist countries towards becoming equal participants in international relations as part and parcel of the responsibilities of sovereign States in an interdependent world fostered a gradual reconsideration of their ideologically motivated attitudes to the monetary institutions.

Another, perhaps equally important, reason for the lack of interest in participation in the early stages of the Bretton Woods system was economic in nature. The Fund at the time had little to offer economies that had adopted comprehensive planning based chiefly on physical, rather than value, instruments for reaching policy decisions. Initially, the Fund's principal purpose was to mobilize its resources for the stabilization of agreed upon exchange rates with the objective of gradual elimination of foreign exchange controls for current-account transactions, promotion of multilateralism, liberalization of capital flows, and other such developments that hinge essentially on the existence of flexible markets.

The comparatively small volume of trade of the socialist countries and the fact that the bulk of it was conducted under balanced ex ante bilateral trade and payments agreements among themselves left little room for the market type of stabilization measures. This aspect became much more significant as the traditional type of central planning was established in every socialist country by the end of the 1940s and as commercial relations with the market economies were severely curtailed; this is discussed below. In addition, under the rapidly deteriorating environment of East-West co-operation, the socialist countries decided that it was not in their best interests to provide extensive economic information to IMF that would be disseminated on a considerable scale. Moreover, they had no reason to subject their exchange régime and broader macro-economic policies to Fund surveillance. Obtaining access to Bank finance could have been attractive, but since this was available only through Fund membership, the price to pay was probably judged to be too high.

A third phase in the relations between socialist countries and the institutions of the international monetary system can be dated from about the mid-1960s to the early 1970s. Many factors led to a reassessment of the Fund and the Bank. These included the more outward-looking development strategy being explored in Eastern Europe in conjunction with economic reforms aimed at devolution of economic management; the rapid increase in the volume of East-West trade and financial flows, accompanied by a measurable relaxation in East-West tensions; the attempt to introduce multilateralism within CMEA through the creation of the transferable rouble and the International Bank for Economic Co-operation; and the desire of socialist countries to integrate themselves more fully with the international concert of nations. Czechoslovakia, Hungary, Poland and Romania approached the Bank and the Fund. Although one of the inducements to join the Fund may have been the prospect of gaining access to quota drawings, the chief motive for exploring membership at the time was probably the possibility of gaining access to Bank financing and especially of qualifying to tender for the Bank's projects (one of the most important reasons in the fourth phase also). This exploratory phase came to an abrupt end with the deterioration in East-West economic and political relations in late 1968.

The fourth and current phase can be dated from 1972, when Romania joined the Fund and the Bank. China and Hungary were admitted in 1980 and 1982. Poland will probably be admitted in 1986. Aside from gaining access to Bank financing, which tends to provide better borrowing conditions than those emerging in private financial markets, and qualifying to tender for Bank-financed projects in developing countries, the potential and actual role of the special drawing right (SDR), especially as propounded in the Jamaica agreements of January 1976, may have been a third inducement for joining. Although about a decade ago it was envisaged that the SDR would become the world's major reserve asset, at present that does not appear to be a realistic policy goal. However, if that were to occur, countries that do not take part in the SDR scheme but wish to participate flexibly in international trade and finance would suffer a distinct disadvantage. The momentum towards establishing the SDR as the chief international reserve asset, however, has dissipated in international monetary discussions. For the time being, therefore, the SDR is not a major issue to weigh in the involvement of the socialist countries in multilateral monetary institutions.

Official stance on the international monetary system and the new international economic order

The most broadly based statement of the fundamental principles that should govern the international trade and monetary systems was made by modified Group D at a number of UNCTAD meetings - in particular in papers submitted to UNCTAD at its fourth session, held at Nairobi in 1976, 14/ especially in the joint statement 15/ (hereinafter, the joint statement is referred to as the "Nairobi statement"). A number of high-level officials of socialist countries, however, had previously indicated directions of desirable change in the international monetary system. Two notable examples were UNCTAD expert group meetings in which representatives of several socialist countries actively participated. 16/ One of the proposals advocated in these forums, as in many others at that time, was to raise the price of gold and reinforce the role of "outside money", as will be explained below.

Of course, several countries have changed their positions on a number of occasions since the fourth session of UNCTAD in order to take into account changing circumstances in the world economy and international relations. Nevertheless, the substantive points regarding the international monetary system contained in the statements of those who originally endorsed the Nairobi statement have not been modified in any major way. 17/ Moreover, these principles are held so generally that they would appear to be shared by nearly all of the socialist countries.

The socialist countries derive their general view of the world economy and their particular view of international economic relations from a set of fundamental principles which were first elaborated in the USSR and subsequently in most other socialist countries. These principles parallel closely the major provisions of the Charter of Economic Rights and Duties of States, for which they were a source of inspiration. Accordingly, countries should express a clear interest in enhancing international economic and other relations when they are mutually advantageous and can be conducted on the basis of an equitable division of labour. The latter can be achieved when relations are based on "the right of each people to decide its own internal affairs; strict respect for territorial integrity and the inviolability of frontiers; mutual advantage; recognition of the right of each State ... to play an equal part in international life and to develop relations with any countries; and full and unconditional recognition of the sovereignty [of States] over their natural resources". 18/ A corollary of these principles is that the more they are comprehensively adhered to, the wider the scope for fruitful international

relations and the larger the volume of economic interaction that the socialist countries will be able and willing to engage in.

As far as the basic issues of the reform of the international monetary system are concerned, the socialist countries stress that it is "obviously impossible to limit the process of transformation to specific fields of international economic relations". 19/ Any process of reforming the international monetary system, therefore, will have to be conceived in terms of a holistic concept of international economic and political behaviour.

As the majority of socialist countries put it, the developed market economies are responsible, even after the end of the colonial era, for "the dependence, exploitation and inequity" 20/ in which the developing countries find themselves. 21/ For that reason, socialist countries support a "radical restructuring of the entire system of international economic relations". 22/ This assertion refers in particular to the "international organizations whose charters and practice remain profoundly undemocratic and deprive the developing countries of the opportunity of taking an equitable part in their work". 23/ The position held on subsidiary issues, even when not spelt out explicitly and in full detail, can be inferred from the above general assessments.

Regarding money and finance and the restructuring of the international monetary system, Group D officially rejects the usefulness of measures aimed "at the 'demonetization' of gold, its replacement by special drawing rights (SDRs) and the legalizing of 'floating exchange rates', [which] cannot provide stability and reliability for the international monetary mechanism [or] remove the basic shortcomings of the present international monetary system". 24/ In order to normalize the international monetary situation these socialist countries advocate in principle measures "to enhance the role of gold in international liquidity and to bring about the gradual abolition and banning of the monopolistic position held by one or several national currencies in the international monetary system". 25/ However, since the SDR system exists, Group D maintains that the developing countries are correct when they propose that a part of the SDR allocations should be earmarked for development assistance. Group D takes a sceptical view of proposals aimed at reforming IMF from within, and suggests instead that UNCTAD would be "a more suitable forum for taking decisions on international monetary problems". 26/

Recent position statements

Since the fourth session of UNCTAD, China has been participating much more actively in international relations and several other socialist countries have either joined IMF and the World Bank (e.g., Hungary) or revived their participation (e.g., China and Viet Nam). The policy positions of these countries on SDR allocations, the role of gold, the lending practices of the World Bank, and related issues have probably undergone some transformation in the process. If such fundamental shifts have taken place, however, they do not appear to have been widely publicized to date. Perhaps the only exception has been the debt issue, financial difficulties having gathered force in the early 1980s. Furthermore, the positions taken at Nairobi need not be absolute: very often pragmatism, rather than doctrinal attachments or other fixed positions, is the driving force of what emanates in fact from the international relations in which the socialist countries are involved. Nevertheless, the Nairobi statement contains some important indicators of the directions in which the socialist countries would prefer that

reform of the international monetary system be undertaken. This is especially the case for regaining "stability" and the neutral role of "outside money".

The CMEA countries have recently stressed that they "favour the regulation of currency and financial relations and oppose the policy of high interest rates; and they favour normalization of conditions under which credits are granted and paid back so that those conditions, particularly as they relate to the indebtedness of the developing countries, should not be used as a means of political pressure and interference in internal affairs" (A/39/323, annex II). They have declared themselves to be in favour, in principle, of convening an international conference on money and finance "with a view to democratizing the current international monetary and financial system on a just and equal basis". 27/ The positions to be argued at such a conference, however, "will depend on how the specific tasks of the conference are formulated and on the extent to which the legitimate interests of all States are taken into account during the preparatory work". 28/

In a joint statement circulated at the sixth session of UNCTAD (Belgrade, June/July 1983), Group D set out seven rules and principles to be observed in convening an international conference on money and finance. Emphasis was placed on viewing monetary affairs in a global economic and commercial context and not in isolation, on approaching all international economic issues uniformly, and on the right of each country to maintain autonomous currency and monetary régimes as long as such régimes did not place other countries at a disadvantage. 29/ Poland has stressed recently that one of the basic pre-conditions of the reliable and smooth functioning of the international monetary and financial system consists in the identification of mechanisms which would allow settlement of the problem of global indebtedness in an efficient and long-term manner thus stimulating universal economic recovery. 30/ Romania has presented several proposals on debt reduction and alleviation for many developing countries.

CRITIQUE OF THE BRETTON WOODS SYSTEM

Although the Soviet Union succeeded in substantially modifying the Articles of Agreement of IMF in 1943-1944, the issues raised during the negotiations have dominated the official attitude of that country to the Bretton Woods system and modifications thereto since the early 1970s. This is true of most of the other socialist countries as well. Rather than examining the historical setting of each separate issue, the present section briefly reviews the position of socialist countries on these issues. The review is mainly derived from published sources. It is possible, however, that if the socialist countries were indeed to participate in the international monetary system their positions might be less rigid than their published policy statements suggest.

Key objections to the Bretton Woods system have centred on (a) the role of gold; (b) the role of the United States dollar, the SDR and the creation of international liquidity; (c) the distribution of voting power; (d) the surveillance role of IMF and the adjustment process; (e) balance-of-payments and stabilization policies; (f) convertibility and exchange rates; and (g) the disclosure of economic information.

The role of gold in the international monetary system

Gold production, foreign exchange reserves, quotas and related matters played a very important role in the initial negotiations on the Articles of Agreement.

The Soviet Union did not challenge the role of gold as a basic international reserve. It did object, however, to the transfer of gold reserves to the territory of the United States, the level of the assessed gold quota for some countries, the earmarking of newly mined gold to work off quota drawings, and the disclosure of economic information about gold production and reserves. Except for the USSR, the socialist countries are not substantial gold producers. 31/ Their position regarding the role of gold in the international monetary system, until the demise of the gold-exchange standard, clearly mirrored that of the USSR. 32/

The socialist countries have a particular attachment to gold chiefly because they regard gold, in addition to its intrinsic merits as a store of wealth, as a basic reserve instrument, an essential stabilizer in international economic relations and an instrument of discipline in national monetary affairs. These precepts play a vital role in Marxist economic theory, which to a large extent conditions academic thinking in a number of the socialist countries. Academic positions, in turn, have a direct or indirect bearing on the motivations that appear to underlie official policy enunciations.

In Marxian theory, money is regarded as a special commodity that serves as a universal embodiment of abstract labour and as a bearer of exchange value. It is considered the crystallization of the exchange value of commodities. Accordingly, the value of money derives essentially from goods. While the commodity backing of money has changed over time, gold eventually became the de facto quasi-universal backing of national and international liquidity. The policy stance on gold has also resulted from ideological concerns because the monetary goals that emerged in the 1970s are viewed largely as another manifestation of the more general aims of the capitalist system. This has led some socialist authorities to gradually adopt a somewhat unusual contemporary attitude towards the role of gold in the international monetary system, as discussed below.

By virtue of gold's scarcity, the issuance of fiduciary money in strict proportion to gold reserves provides a strong element of discipline in national monetary policies and in balance-of-payments adjustment efforts. Gold is a form of "outside money" since its issuance, intrinsic value and volume of circulation do not depend on the goodwill of any one country or group of countries. Credit money issued only in a loose relationship to its "commodity" or "reserve" backing is held to lead to uncontrollable inflation and monetary chaos with all the ensuing adverse consequences for employment, economic stability and the pace at which growth can be sustained.

The USSR, of course, is the world's second largest gold producer and thus has an obvious stake in the role of gold for monetary purposes. This follows also from the distinct preference of policy makers in socialist countries for a stable domestic and external environment. Such an environment is viewed as making it possible to take economic decisions on their own merit. By allotting a broad role to gold in monetary relations, it is assumed that the stability of the international environment can be assured.

The role of national and international reserve currencies

Most economists and policy makers of the socialist countries stress the fundamental contradiction between the use of national currencies as international reserves and the provision of adequate liquidity backed by a "basic" international value. They also emphasize the potential conflict between the need for monetary stability and the exploration of purely international reserve currencies, such as

the SDR. They attribute this conflict to the fact that the creation of purely international reserve currencies is not mainly motivated by the need for adequate liquidity. The socialist countries regard the direct relationship between the creation of international reserves and the need for adequate liquidity as an essential component of a stable economic environment.

Socialist countries have been concerned about the lack of monetary discipline and responsibility on the part of key developed market economies in both domestic and international affairs. This criticism has been especially forceful since the abandonment of fixed exchange rates in the early 1970s. But it had been levied before, chiefly in connection with the balance-of-payments deficits of the United States in the 1960s. Most socialist countries argue that the excessive issue of currency and credit, persistent balance-of-payments deficits to remedy the shortage of international liquidity, and the demonetization of gold have all led to uncontrollable inflationary pressures. These pressures have had adverse consequences, in particular for the developing countries, and therefore need to be eliminated.

Distribution of voting power

The question of the voting system in IMF and the World Bank has been raised on a number of occasions. In brief, the socialist countries object to the allocation of voting power by economic strength. They view this state of affairs as an exercise in dollar hegemony and as interfering in the internal economic affairs of sovereign States. As a result, and especially since the Declaration on the Establishment of a New International Economic Order (General Assembly resolution 3201 (S-VI)), they have called for a "democratization" of the official monetary system. The socialist countries advocate that institutions move closer to the one-country-one-vote system typical of their own regional organizations and of the United Nations system.

Surveillance and the adjustment process

Together with many developing and some developed countries, the socialist countries have expressed concern about the adjustment processes embedded in the Bretton Woods system and even more so in the guidelines gradually adopted during the period of flexible exchange rates. The argument is quite general: they subscribe to the notion that the adjustment burden has fallen disproportionately on the countries encountering balance-of-payments deficits, while disequilibrium has usually been due to unsynchronized macro-economic policies in both surplus and deficit countries, or perhaps even overwhelmingly on account of mercantilist policies on the part of the surplus countries.

Balance-of-payments and stabilization policies

The authority of IMF to prescribe stabilization policies for members who find themselves in external payments difficulties has been a major objection to more active involvement with IMF and the Bank. As discussed below, the centrally planned economies encounter considerable problems with adjustments that are to be pursued with instruments of indirect economic control (such as prices, exchange rates, interest rates, money supply and credit creation, and government expenditures). Adjustments in these instruments are the key policy targets of Fund recommendations. At the same time, it should be clear that centrally planned economies may find it easier than many developing market economies to pursue adjustment policies similar to those that IMF normally prescribes. The goals of

reducing domestic absorption and of moving resources to the export sector can be achieved relatively quickly and on a considerable scale with the planning and intervention instruments typical of centrally planned economies.

It is, then, not so much the goals or the means of attaining them that are the obstacle as far as the stabilization measures endorsed by the Fund are concerned. The central problem would appear to be the authority of the Fund to prescribe in principle the timing and scope of such policies, both of which the socialist countries continue to contest on the ground that they constitute an inadmissible interference in their internal affairs. 33/

Convertibility and exchange rates

Exchange rates in centrally planned economies do not play the same role as they do in market economies. In fact, the type of central planning typically embraced in socialist economies is incompatible with the Fund's prescriptions on commodity and currency convertibility for current-account transactions. This is especially so when convertibility prescriptions are meant to be applied in actual economic decision-making. For most commercial purposes, exchange rates normally play no market role in the socialist countries. In other transactions, their role is highly circumscribed.

In principle, socialist countries do not have difficulties with a system of fixed exchange rates anchored to gold parities. They have continued to embrace such a régime for themselves, even though it has remained largely notional for the bulk of their external transactions. The choice of the exchange régime and changes therein, however, are held to be the prerogative of each country. They maintain that IMF should not insist on convertibility in the real sense since it is incompatible with the essential operational features of strict central planning for structural change.

In addition, socialist countries have traditionally refused to consult IMF about their exchange rate policies. They have also found it rather difficult to reconcile their own exchange régime with the system of flexible exchange rates in their operations in international markets.

Information disclosure

Disclosure of important economic information has been a divisive issue from the very start of the debate about the creation of IMF and the World Bank. While it is true that the Soviet delegation did not lodge any reservations concerning the provision of economic information to the international institutions when the draft Articles of Agreement were signed, the issue has been consistently included in the criticism of the Bretton Woods system made by socialist countries. Clearly, at the height of the cold war there were arguably legitimate reasons for socialist countries to restrict economic information. Since that time, much has changed, but some socialist countries still do not publish sufficient information to permit a straightforward and comprehensive assessment of their economic situation.

PARTICIPATION OF THE SOCIALIST COUNTRIES IN AN INTERNATIONAL MONETARY SYSTEM: SOME OBSERVATIONS

The socialist countries are critical of both past and present world monetary systems, which they perceive as a club of a few large capitalist countries and a

vehicle for promoting the hegemony of one, or at most a few, key currencies. Contemporary monetary problems are viewed as aspects of the more general economic crisis of capitalism whose roots lie in the economic policies pursued by large developed market economies and by the United States in particular. 34/ Rarely do political leaders or even informed commentators offer a comprehensive proposal for correcting the monetary disorder in the post-Bretton Woods world.

Socialist countries have not committed themselves to what the solution should be or to whether it could be hammered out at another international monetary conference. Indeed whether they will participate in such a conference depends critically "on how the specific tasks of the conference are formulated and on the extent to which the legitimate interests of all States are taken into account during the preparatory work". 35/

Most of the objections to the world monetary system made by socialist countries concern basic principles or general guidelines of policy-making in these countries or in the monetary institutions themselves. At the present time, participation in the world's monetary institutions presents fundamental as well as operational objections in socialist countries. A more pragmatic approach, however, is likely to inspire greater participation in the international monetary system. Before discussing the elements of this pragmatic approach, it is useful to review briefly the objections. Since several countries already participate, this review will be conducted with an eye to specifying the conditions under which all socialist countries, or at least the more important members of the group, could become full participants in the present monetary system. It should be noted that most objections to past and present monetary systems relate to the interpretation of the Articles of Agreement and especially to the way in which the Fund has applied the Articles. The system, however, has undergone a number of substantial modifications that need to be factored into the analysis.

Characteristics of centrally planned economies

In the early post-war period, the domestic economic environment chosen by the centrally planned economies was characterized by (a) comprehensive central planning chiefly by way of physical yardsticks; (b) commodity and currency inconvertibility; (c) a marked separation of the domestic economy from foreign economic transactions, except at the macro-economic level; (d) strict bilateralism in foreign trade and payments; and (e) rapid domestic industrialization under state guidance. These goals, instruments and institutions explicitly de-emphasized or neglected value indicators and most indirect instruments of economic management. The ramifications of the particular development pattern chosen by these countries and the institutions and instruments established to support the industrialization strategy minimized the role of money. They also curtailed the interaction of the socialist countries with market economies even further than the already substantial curtailment on account of political disagreements. Yet such features as multiple exchange rates, which reflect the two-tier price system typical of centrally planned economies; currency and commodity inconvertibility, which derives from the planned allocation of resources; bilateralism, which was resorted to so as to facilitate the planned conduct of foreign trade; and exchange controls to insulate domestic from foreign markets, and thus to enhance the effective realization of centrally planned decisions, are all logical and legitimate ingredients of the economic set-up of centrally planned economies.

In contrast, the Bretton Woods system was basically designed for developed market economies. It never really tried to understand and come to grips with the particular problems posed by the economic and institutional characteristics of the centrally planned economies. The Bretton Woods system centred on the market mechanism, private profit incentives, single equilibrium exchange rates, convertibility, multilateralism and the absence of exchange restrictions. Fund assistance was directed towards temporary balance-of-payments problems. This could be of interest to centrally planned economies as well - for instance, in the case of a sharp harvest failure. If properly dovetailed plans were always realized, of course, assistance from IMF would not be required.

Under normal circumstances, however, internal or external imbalances in centrally planned economies are worked off through inventory changes or through foreign borrowing, and subsequently by planning for their reversal at the time of the elaboration of the next socio-economic plan. Indirect instruments of economic administration play only a subsidiary role, and it would therefore be counter-productive to resort to the typical stabilization measures advocated by the Fund. For example, since prices play only a limited role in determining aggregate demand and supply, changes in indirect taxes and subsidies are not likely to rectify the imbalance. Furthermore, since the foreign sector exerts no direct influence on either the macro- or micro-economic allocation of resources, a change in the exchange rate will not divert resources to the foreign sector and bolster exports. Similarly, since the money supply is regulated especially to make the implementation of the plan possible, the standard prescriptions on monetary control will not work in the context of centrally planned economies. Monetary control in these countries is simple given the uncomplicated structure of financial institutions, the limited range of financial assets offered to domestic and foreign residents, and the nearly complete insulation of the domestic monetary system from external financial transactions.

These economies, however, could gain from some type of association with the system. Besides the psychological benefits of near-global participation in a uniform international economic system, the direct gains are securing access to credit facilities at moderate interest rates; achieving greater financial respectability in market economies; having access to a considerable store of expertise in debt management and rescheduling, and in the costs and benefits of various economic austerity policies; obtaining the right to bid on Bank projects in developing countries; and, for the poorer of the planned economies, gaining the status of a developing country at the Bank and hence obtaining access to convertible currency funds on particularly advantageous terms.

Key ingredients of the international monetary system advocated by socialist countries

The following key features would encourage fuller participation of socialist countries in the international monetary system: an "ideal" currency, universal participation, more stable exchange rates, a stable reserve currency, a role for gold, more equality in voting, less asymmetry in surveillance and adjustment prescriptions, perhaps some form of convertibility, and restricted information disclosure.

A universal reserve currency

Universality requires that a reformed monetary system be anchored to a common *numéraire* to measure value. It should be possible to create such a unit without

making it dependent on any one of the major currencies. In other words, it should be an ideal currency, perhaps along the lines of the Bancor or the transferable rouble. The SDR might become such a unit, but for it to be acceptable to the socialist countries, modifications in its creation and distribution, and perhaps in several other of its features, would have to be worked out. 36/

Universalism that is anchored to a common numéraire, however, does not preclude monetary polycentrism. 37/ Indeed, without such a plurality of currency zones it is difficult to see how the transferable rouble - or the Soviet rouble for that matter - could be strengthened and rendered compatible with a new monetary system while avoiding important systemic changes that might compromise the expressed interests of some centrally planned economies.

The foreign exchange régime

In regard to "stable but equitable" exchange rates, the socialist countries tend to favour "stability" over "adjustability". 38/ In particular, these countries view the costs of instability and uncertainty associated with a floating exchange régime as outweighing the benefits of a measure of internal autonomy associated with this régime.

Any reformed international monetary system is most unlikely to depart in essential respects from the present situation - in some cases, the present aims - of currency convertibility, multilateralism in trade, unique equilibrium exchange rates and gradually liberalized capital markets. As mentioned above, these features may pose problems for the socialist countries that for systemic or other reasons deliberately opt not to pursue such goals.

Ways to accommodate socialist countries in particular exchange régimes, be they fixed, floating or hybrid, can, of course, be found. The provisions of article VIII of the Fund's Articles of Agreement, if suitably reinterpreted to meet the particular circumstances of centrally planned economies, would be germane. It is highly desirable that such reinterpretation be regulated with more specific parameters than those employed in the mid-1940s.

Gold and reserve currencies

The role of gold in a transformed international monetary system will certainly be of considerable concern to a number of socialist countries, as discussed below. But there are likely to be other reserve instruments under a reshaped world monetary system. The role of the SDR and the attitude of the socialist countries towards that reserve unit are of particular concern. The socialist countries regard the SDR as having an important place in the evolution of international currency reserves. 39/ Many monetary experts of socialist countries view the SDR as an embryonic form of debt money. But as long as its creation is not placed under strict control and in line with the requirements of a stable trading and economic environment for the world as a whole, it cannot solve prevailing monetary problems.

An important question is whether countries will be able to participate in the SDR system without becoming full members of the Fund and associated institutions. It is true that the Fund's revised Articles of Agreement provide for this possibility. But it is not clear whether the relevant provisions can be extended to cover socialist countries that are not members. 40/

In recent years the socialist countries have been advocating the development of stable units of account for international economic agreements. For example, they have taken an active role in the Study Group on International Payments of the United Nations Commission on International Trade Law, which deals with the establishment of a universal accounting unit with constant value. In fact, the USSR declared in January 1982 at Vienna that an indexed SDR could be acceptable as such a unit, 41/ especially in assessing national contributions to international organizations or international insurance conventions. Some socialist countries have actually gone so far as to sign credit agreements based on a basket of currencies that is similar to the composition of the SDR. 42/ For example, the USSR has recently signed two agreements on the financing of imports of Swedish capital goods that are tied to the European currency unit (ECU). 43/ In June 1985, the International Bank for Economic Co-operation started quoting the ECU in terms of the transferable rouble.

Internationalization of the monetary institutions

The universality aimed at in the Bretton Woods system was in fact an attempt to extend uniform conditions throughout the world that were based largely on the economic institutions and behaviour of developed market economies. It is an established fact that the countries with the largest voting power at the Fund can decide autonomously what borrowing can take place, the conditionality to be attached and the particular type of adjustment policies to be set. However, section 3 (b) of article IV, of the Articles of Agreement states that the principles adopted by the Fund for purposes of surveillance "shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members". This was one of the principal stipulations hammered out at Bretton Woods. Moreover, in practice, increasing resort has been made to the stipulation that Fund policies be conceived within the organizational and social parameters of the country concerned, with some room for ad hoc accommodation through negotiations. This stipulation was restated in March 1979 to clarify existing doctrine on conditionality and to reflect existing practice. The guideline adopted at Bretton Woods, by which the Fund was to pay due regard to domestic social and political objectives and the particular causes of balance-of-payments problems, was re-emphasized. Though that may not have involved a reversal of matters of principle, for a short while at least a more liberal application of conditionality did take place with regard to the relatively few developing countries that were then facing external payments problems. But this policy was reversed in 1981-1982 and again more recently. This more flexible approach to the problems of the developing countries could be suitably adapted to the particular situation of centrally planned economies.

The socialist countries are likely to insist upon a considerable degree of national autonomy, even though they have on occasion argued the case for strengthening the role of the Bretton Woods institutions well beyond the co-ordination of exchange rate policies. 44/ Global international monetary institutions can be successful only if they explicitly recognize members' interests in maintaining a degree of autonomy and economic sovereignty consonant with the basic principles of international economic relations.

Voting power

The socialist countries appear to be bent on acquiring greater power over the policy-making of monetary institutions without necessarily committing themselves to absolute equality. It is important to note that (a) voting rules have been

considerably relaxed, for instance, as a result of ad hoc borrowing facilities with various kinds of majorities; (b) on key decisions the deciding majority is rather high (in some cases, as high as 85 per cent); (c) the socialist countries as a group would have more than 15 per cent of the voting power, thus gaining veto power; 45/ and (d) most operational questions within the Bretton Woods system are settled by broad consensus rather than formal voting. The high deciding majority applies, for instance, to the creation of liquidity in the form of a new tranche or SDR allocations, for example. This has been a matter of paramount importance to socialist countries.

Given these facts, the socialist countries' insistence on voting equality would appear to release, first, to the basic principles underlying the system and, secondly, to a starting position that can be considerably modified during negotiations. Thus, there are no objections in principle to the present members agreeing to a voting allocation on issues of particular concern to the socialist countries that would in effect provide them with veto power. This would be the case, for example, in the application of Fund adjustment policies to these countries. In addition, non-socialist countries might safeguard their basic interests by keeping their present voting power, after duly taking into account the concerns of the developing countries, on matters that are not of vital importance to socialist countries. This might occur in establishing guidelines for parities and for fluctuations in exchange rates, and perhaps even in foreign exchange policies in general.

If reform were to institutionalize a plurality of currency zones, the apportionment of voting power among the zones would be of considerable interest. The socialist countries would tend to favour equality of voting power among the various blocs. But the question of voting power need not be settled uniformly for every decision.

Symmetry in adjustment

Given their critique about the way in which the Fund has exercised its surveillance and adjustment roles in recent years, the socialist countries will almost certainly insist on greater symmetry in adjustment. But they are unlikely to agree to a greater degree of autonomy for an international organization such as the Fund, since they oppose interference in internal economic affairs of member countries as a fundamental principle of international law.

Nevertheless, socialist countries do advocate greater surveillance of both developed and developing market economies because they consider that economic policy and especially monetary policy have not been controlled well in many of these countries at the national level and even less so at the international level; nor have they been co-ordinated to the degree required for stable and sustainable economic growth for all participants in the world economy.

Convertibility

Since convertibility is a critical issue in any monetary system, would the currencies of the socialist countries have to be made convertible? Would they have to be traded in world markets and their prices determined by the market mechanism? Would these currencies have to be exchangeable into domestic commodities or services, at least in principle? If so, they would be critical determinants of the internal price structures of their economies.

Some socialist countries, including Hungary and Poland, have expressed serious interest in making their currencies convertible to a degree. But they envisage, initially, only a very limited form of external financial convertibility. This could be created relatively easily by all countries. Whether the majority of socialist countries would be willing to proceed very far with this process, especially in the direction of goods' convertibility, however, is a different matter. The CMEA members officially committed themselves in 1971 to a comprehensive study of the full range of questions associated with convertibility of the transferable rouble and national currencies with a view to adopting a common strategy by 1980. 46/ They have made some progress with the creation of a limited form of convertibility for non-commercial transactions within CMEA, but the full range of policy issues pertaining to currency convertibility for current account transactions for most members has not yet been resolved.

The answer to the above questions would therefore have to be formulated, first, in relation to a process and timetable for moving towards some minimum acceptable form of convertibility and, secondly, with sufficient flexibility so that modifications could be undertaken in the light of emerging internal and external developments.

Information disclosure

For several reasons the question of information is not an issue at the present time for most socialist countries, except perhaps for the USSR. First, information can be provided on a confidential basis so that it will not be disseminated by the Fund. This has worked reasonably well thus far, but it is not likely that sensitive data for the USSR would be contained within the Fund. Secondly, much has changed since the socialist countries relegated nearly all quantitative and qualitative economic information to the category of "state secret". Some countries still do not publish sufficient information to permit straightforward and comprehensive assessments of their economic situation. None the less, and thirdly, a fairly reliable picture of broad short- and medium-term macro-economic trends in most socialist countries can be easily constructed. Moreover, the Fund is no longer as insistent on the rigorous provision of information by its members on a timely basis for publication. This has been the case of Romania since its admission in 1972; the information is provided to the Fund but most of it is not included in the Fund's standard publications.

The role of gold

The only specific recommendation contained in the Nairobi statement concerned a return to gold as the basic anchor of a reformed international monetary system. Whether such a reinstitution of the gold standard or a gold-exchange standard is desirable from the point of view of the stability and reliability of the international monetary system, and whether it would be feasible, are two different questions.

Since the demise of the gold-exchange standard, monetary theory in the socialist countries, especially in the USSR, has been sharply divided between two distinct academic groups with connections to government decision makers. 47/ The more traditional group views the collapse of the gold standard as having provoked the chronic chaos of the capitalist economy. These commentators regard the Bretton Woods system as having been far from satisfactory, particularly because it fostered the world-wide domination of the United States dollar. Nevertheless, they acknowledge that the merit of the system was ultimately its being based on gold,

which, according to them, is the key "disciplining tool" 48/ in international economic relations. Still there has been growing recognition by this group of commentators that the "function of gold as a universal equivalent is changing". 49/

The other academic group maintains that gold is not the single most important factor of the monetary crisis. 50/ Gold had already lost its most important attributes as a universal commodity and world money well before the onset of the crisis; indeed, this erosion had started with the establishment of the gold-dollar standard. Various explanations are put forward, including rise in international tensions stemming from economic conflicts among major countries; resentment of the exclusive role of the dollar and the policy freedom it affords the United States; and the conflict between monetary nationalism and the supranational tendencies built into the Fund's surveillance mechanisms. The energy crisis and stagflation only accelerated the demise of gold as universal money. Although this group of commentators does not believe that the end of the gold-exchange standard totally explains the crisis of the international monetary system, it argues that the crisis can be resolved only by devising a way out in which the role of gold must necessarily be taken into account. The demonetization of gold is seen as harmful to the stability of the international monetary system. 51/ But the precise role that gold should play in a new international monetary system remains unclear.

The socialist countries have not released any official policy statement on the gold issue since 1976. It is therefore legitimate to ask whether, after the experiences of the past decade, a return to gold is still being advocated. In the absence of official statements, no categorical answer can be provided here. There are, however, two indirect indicators that suggest that gold is no longer being advocated as the basic reserve currency of a reformed international monetary system: (a) the apparent shift in the balance of the debate from the "traditionalists" to the "modernists", and (b) the official silence on the potential shape of international monetary reform.

Although the debate between the two academic groups of monetary experts does not yet appear to be over, there has been a noticeable shift in favour of those who argue against a return to the gold standard or the gold-exchange standard. The reinstitution of gold is no longer considered to be feasible and therefore deserves no further support or research. The strengthening of international liquidity is seen as emanating from relatively stable units of account (including the ECU and the SDR), as well as from yen and the dollar. 52/ Both groups remain sceptical about the role of national currencies as international reserves.

Other indirect evidence is a statement by the Deputy Minister of Finance of the USSR: in a recent in-depth analysis of the role of gold in the world economy, he concludes that it is "absolutely beyond dispute" that the discussions of a return to an official conversion of paper money into gold are utopian and unrealistic; "the gold-standard mechanism is definitely something of the past, none of the objective economic conditions for its restoration prevails, and any attempt to agitate in that direction is in advance condemned to failure". 53/

Since 1976, none of the socialist countries has suggested in a comprehensive way, similar to the Nairobi statement, how the monetary system could be usefully modified. 54/

Participation in the existing system

There are various ways in which the centrally planned economies could participate in the present international monetary system or in a reformed one. The latter could be devised in several ways - for instance, reform from within the existing system, a newly created global monetary system, or a system consisting of several layers, universal only by virtue of all parts being anchored to a central system. 55/

Accession to the Bretton Woods system

One way to participate more actively in the existing system that has been pursued by several countries in recent years has been to accede directly to the Articles of Agreement without any special reservations being accommodated in the process. Although this would seem to contradict the policy stance and analysis of the world's monetary ills discussed above, it was motivated chiefly by pragmatic economic and financial considerations.

Certainly, in the case of Hungary, Romania and, to a lesser extent, Yugoslavia, the Fund has had to come to grips with the special circumstances of centrally planned economies. 56/ Since these economies can meet Fund criteria through the well-tried policy instruments of central planning, there was not any great incompatibility between the Fund and these economies. In other words, for those wishing to participate in the Fund, a different adjustment régime can be worked out in consultation with the Fund. A different set of issues, of course, is present in the setting of goals acceptable to both the Fund and the centrally planned economy in question. But that thorny problem arises in the Fund's relations with market economies as well.

From the point of view of international economics, therefore, there are not that many arguments that can be brought to bear against the socialist countries' accession to membership in the present international monetary organizations. As explained above, the major objections levied against the gold subscription, the central role of a national currency, the voting allocation, the adjustment programmes, the determination of exchange rates, the disclosure of information and so forth have all been sufficiently watered down by past Fund practices with socialist countries that joined IMF and even more so with many of the developing countries.

Outright membership in the World Bank and IMF may bring measurable benefits in terms of access to additional loans. China, Hungary, Romania and Yugoslavia have all benefited from access to Bank loans and drawings from IMF. This alternative source of capital may appear increasingly attractive to several other centrally planned economies in the years ahead, although direct financial benefits are only one of the reasons for membership. Neither substantial quota drawings nor soft loans would probably be a realistic prospect in the case of the USSR, since its quota would inevitably be substantial and it could not possibly be considered a developing country. The USSR is therefore likely to weigh carefully the costs associated with Fund obligations against the benefits of a quota.

Two objections to joining IMF are likely to arise. First, some socialist countries will find the price to be paid far too high relative to the benefits to be derived in terms of drawing rights, soft loans and contract bidding. Secondly, it may prove politically undesirable to join the capitalist institutions outright. If either of these objections were to inhibit the implementation of meaningful

monetary reforms, a solution should be sought so that the socialist countries could become part of a new international monetary system without being obliged to join in a system that is politically unacceptable.

Reform of the Fund from within

Given the basic objections of the socialist countries to key principles of the Bretton Woods system, another way in which they could become associated with it would be through reform of the Fund from within. The existing system would essentially be retained, but some of the Articles of Agreement and operational mechanisms of the Fund could be modified and some new paragraphs added to take into account the special features and needs of centrally planned economies.

The realism of this possibility, however, is in doubt. In a working paper submitted to UNCTAD at its fourth session, Group D states that:

> "The proposals made within the framework of IMF to modify the basis of the existing international monetary mechanism will neither ensure normal currency dealings nor establish conditions to provide stability and the necessary confidence in such an international monetary system. The proposed modification of the Articles of Agreement of IMF would serve to entrench the privileged position of several Western countries in that organization." 57/

In theory, it would be possible to establish the transferable rouble monetary region as a subsystem linked to IMF through a technical relationship. This could take several forms. One would be to link the transferable rouble and the SDR directly through a technical agreement between the International Bank for Economic Co-operation and IMF that would offer drawing rights to socialist countries that are not formal members. For example, an interested country could borrow SDRs from IMF and subsequently contract a loan in transferable roubles that would be convertible upon demand. CMEA as a whole would be held responsible for the repayment of the SDR loan. Since access to a new source of finance is thus provided without the country becoming a full member of IMF, this option might be of considerable interest to a number of centrally planned economies. The thorny issue of who would in the end be called upon to shoulder this service, however, needs to be resolved first within the CMEA framework. Furthermore, it is doubtful whether IMF and the majority of socialist countries would prefer such a link over direct membership especially at this juncture of international economic and financial relations. Several socialist countries would probably not deem it worth their while to jump through the successive hoops required merely to obtain SDR-backed loans.

A more useful suggestion might be the creation of a set of rules for non-market economies similar to those that permitted accession to the General Agreement on Tariffs and Trade (GATT) for such countries as Poland and Romania. 58/ In the case of GATT, negotiations over tariffs and most-favoured-nation (MFN) treatment to be accorded by centrally planned economies were waived in favour of an agreement on a minimum rate of growth of their trade with GATT signatories in exchange for MFN treatment accorded by the GATT members with market economies. This solution was not acceptable to Hungary when it was negotiating in the early 1970s.

It is doubtful whether the CMEA countries that are IMF members would be willing to replace their present direct relationship with an indirect one through the International Bank for Economic Development. Perhaps a more feasible policy

might be to have a dual status: a special technical link between that Bank and IMF for those centrally planned economies that do not wish to join IMF now or in the foreseeable future, and full membership for those that wish to do so now or in the near future.

A new world monetary system

The socialist countries have repeatedly called for a restructuring of the present system of international economic relations on a just, equitable and democratic basis. In fact, the socialist countries have argued that another international conference on money and finance should be convened "with a view to democratizing the current international monetary and financial system on a just and equal basis" (A/38/479, annex, para. 2). If this is actually sought, it would require a considerable change in the Articles of Agreement. The Fund probably would not survive, save perhaps in name.

Some key Soviet and Eastern European observers have commented on desirable or mandatory conditions for monetary reform. For example, the Deputy Chairman of the Hungarian National Bank sees the following as prerequisites for a workable international monetary system: (a) a universal monetary institution under the aegis of the United Nations that would be empowered, under rules to be laid down, to issue new international money as the key currency in the new international monetary system, its convertibility being guaranteed not by one country, as under the gold-exchange standard, or by each country, as under the gold standard, but jointly by all participants in the system; (b) the regulation of the gold problem by using it as a numéraire for establishing the exchange rate between gold and the new world currency; (c) the establishment of realistic parities between convertible currencies and the new world currency that would be stable but with an exchange rate mechanism much more flexible than that of the Bretton Woods system; and (d) within this framework modalities would have to be worked out on how to eliminate bottle-necks in international credit relations, on how to make available economically warranted long-term loan capital or on how to meet capital requirements in an organized way. 59/

Most Soviet observers appear to advocate one or more of the following conditions for the emergence of a new system of international monetary and credit relations that meets the interests of States with different socio-economic systems and at different levels of development: 60/ (a) a healthy international political climate; (b) the prior removal of chronic payments imbalances in developed market economies and the installation of symmetry in adjustment - that is, both surplus and deficit countries ought to adjust with equal vigour; (c) limitations on the practice of floating exchange rates and provision for compensation for losses sustained as a result of sharp changes in exchange rates of main currencies; and (d) better ways and methods of ensuring economic co-operation through more perfect forms of international liquidity. The instrument of international liquidity must be acceptable to all participants in international exchange. It must be neutral, sufficiently stable and protected from the influence of fluctuations in exchange rates of all national currencies. Such a currency is often deemed to be feasible only "when it is based on gold". But, as argued above, this is not likely to be a main requirement at this juncture.

A multi-tier world monetary system

Another form of participation would be the explicit recognition of the de facto existence of several currency zones, each with its own special needs and

characteristics. This would essentially encompass the formalization of the existing monetary régimes, the addition of a few others to ensure universality, and the establishment of formal links among the subsystems that are anchored to the common central system. The European Monetary System, the dollar zone, the yen area, the Arab group and the non-oil developing market economies all have their own financial and monetary needs and peculiarities. Another system could emerge as a result of the establishment of an effective transferable rouble monetary region. Each of these systems could prescribe monetary and financial rules that are deemed to be in the best interest of the respective members. The interaction among the various regions, however, would be subject to common regulations and a universal currency unit yet to be worked out through rules acceptable to all participants. Surveillance and adjustment requirements would be confined to the interaction among currency zones.

Notes

1/ The conventional nomenclature for the group of socialist countries in the studies of the Department of International Economic and Social Affairs of the United Nations Secretariat is centrally planned economies. This group includes China, Eastern Europe (Albania, Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland and Romania), the Democratic People's Republic of Korea, Mongolia, Viet Nam and the Union of Soviet Socialist Republics. Other socialist countries are Cuba, the Lao People's Democratic Republic and Yugoslavia, all of which are included as developing countries. Policy positions have been formulated on occasion in declarations issued by States members of the Council for Mutual Economic Assistance (CMEA) or of the Warsaw Treaty Organization (WTO). The latter group comprises the Eastern European planned economies, except for Albania and the Soviet Union. The group of CMEA countries is somewhat wider since it comprises the WTO members as well as Cuba, Mongolia and Viet Nam; Albania is an inactive member. In forums of the United Nations Conference on Trade and Development (UNCTAD), the socialist countries are usually grouped together as Group D. This includes the Byelorussian Soviet Socialist Republic, Eastern Europe, the Ukrainian Soviet Socialist Republic and the USSR, even though the Group's positions are not usually endorsed explicitly by Albania and Romania. Cuba and Mongolia normally join Group D statements. Hereinafter, Group D excluding Albania and Romania but including Cuba and Mongolia will be referred to as "modified Group D". In addition to the above affiliations, at least six socialist countries (Cuba, the Democratic People's Republic of Korea, the Lao People's Democratic Republic, Romania, Viet Nam and Yugoslavia) are members of the Group of 77 and usually join with that Group on policy matters of direct concern to them.

2/ From the address of the Prime Minister of China, Zhao Ziyang, to the 6th National People's Congress at its first session (as reported in China Daily (Beijing), 24 June 1983, supplement, p. 4).

3/ A representative of the Ministry of Foreign Economic Relations and Trade recently reiterated the eight principles governing China's economic and technical aid that had originally been outlined in 1963 by the then Prime Minister, Zhou Enlai (Li Ke, "China's aid to foreign countries", Beijing Review No. 36 (1983), p. 17). They are part of the standard principles of socialist international economic relations. Premier Zhao Ziyang's four principles, stated in 1982, are designed to uphold these standard principles while, at the same time, laying the ground for a gradual move away from extending assistance through loans. It is now argued that development co-operation activities should be carried out

more and more to the benefit of both partners (Li Ke, loc. cit., p. 183, and China Daily (Beijing), 21 September 1984).

4/ For the early history of IMF, see J. Keith Horsefield, The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Co-operation, vol. I, Chronicle (Washington, D.C., International Monetary Fund, 1969), pp. 77-117; Marie Lavigne, "The International Monetary Fund and the Soviet Union", International Economics: Comparisons and Interdependencies, Friedrich Levcik, ed. (Vienna and New York, Springer-Verlag, 1978), pp. 367-372; and Raymond F. Mikesell, "Negotiating at Bretton Woods", Negotiating with the Russians, Raymond Dennett and Joseph E. Johnson, eds. (Boston, World Peace Foundation, 1951), pp. 101-116.

5/ One of the principal post-war demands of the USSR was economic assistance to ease the reconstruction of its war-ravaged economy. This became, arguably, the thorniest issue in the post-war peace negotiations among the major Powers.

6/ See Horsefield, op. cit., pp. 98-99.

7/ For the details, see Horsefield, op. cit., p. 105. Important Soviet observers, however, still argue that the basic principles embodied in the Articles of Agreement "combined a number of articles which were totally unacceptable" to the socialist countries (Boris S. Fomin, "Monetary and financial aspects of east-west economic co-operation", Money and Finance in East and West, Christopher T. Saunders, ed. (Vienna and New York, Springer-Verlag, 1978), p. 106). The articles found unacceptable apparently related to the allocation of votes, reporting on gold and exchange reserves, transfer of gold to United States territory, convertibility for current-account purposes and the way in which drawings could be made subject to conditionality provisions.

8/ Recent commentary acknowledges the overwhelming role of politics and the Cold War, both of which precluded active participation in the Fund (Mieczyslaw Blusztajn, "Polska a Miedzynarodowy Fundusz Walutowy", Bank i Kredyt (Warsaw), No. 4/5 (1982), p. 109).

9/ Jerzy Kranz, "Panstwa socjalistyczne w MFW i Banku Swiatowym", Sprawy Miedzynarodowy (Warsaw), No. 11 (1984), p. 32.

10/ Blusztajn, loc. cit., p. 109.

11/ Kranz, loc. cit., p. 32.

12/ See the speech as reproduced in The New York Times, 6 March 1946.

13/ Blusztajn, loc. cit., p. 109.

14/ Proceedings of the United Nations Conference on Trade and Development, Fourth Session, vol. I, Report and Annexes (United Nations publication, Sales No. E.76.II.D.10), annex VIII, sects. A to F.

15/ Ibid., sect. F.

16/ See International Monetary Issues and the Developing Countries: Report of the Group of Experts and International Monetary Reform and Co-operation for

Development: Report of the Expert Group on International Monetary Issues (United Nations publications, Sales Nos. E.66.II.D.2 and E.70.II.D.2).

17/ Proceedings of the United Nations Conference on Trade and Development, Fourth Session, vol. I, Report and Annexes (United Nations publication, Sales No. E.76.II.D.10), annex VIII; ibid., Fifth Session, vol. I, Report and Annexes (United Nations publication, Sales No. E.79.II.D.14), annex VII; and ibid., Sixth Session, vol. I, Report and Annexes (United Nations publication, Sales No. E.83.II.D.6), annex VII, sect. D.

18/ "Contribution of the Union of Soviet Socialist Republics to the implementation of the International Development Strategy for the Third United Nations Development Decade" (A/39/273-E/1984/103, annex), paras. 6 and 7. A similar statement was endorsed unanimously at the CMEA high-level Economic Conference held in Moscow in June 1984 ("Deklaratsia stran-chlenov soveta ekonomicheskoy vzaimopomoshchi 'sokranenie mira i mezhdunarodnoe ekonomicheskoe sotrudnichestvo'", Ekonomicheskaya gazeta (Moscow), No. 26 (1984), p. 7), and was transmitted to the members of the General Assembly at its thirty-ninth session (see document A/39/323, annex II).

19/ Wolfgang Spröte, "The socialist countries' position on international economic relations", The Transformation of the International Economic Order, special issue of Asia, Africa, Latin America (Berlin), 1983, p. 23.

20/ Proceedings of the United Nations Conference on Trade and Development, Fifth Session, vol. I, Report and Annexes ..., annex VII, sect. A, para. 14.

21/ This position was apparently first outlined in detail in the joint statement of modified Group D at the fourth session of UNCTAD (Proceedings of the United Nations Conference on Trade and Development, Fourth Session, vol. I, Report and Annexes ..., annex VIII, sect. F.

22/ Proceedings of the United Nations Conference on Trade and Development, Fifth Session, vol. I, Report and Annexes ..., annex VII, sect. A, para. 15.

23/ Ibid., para. 14.

24/ Proceedings of the United Nations Conference on Trade and Development, Fourth Session, vol. I, Report and Annexes ..., annex VIII, sect. E, para. 21.

25/ Ibid., para. 22.

26/ Ibid., para. 26.

27/ "Joint statement of the delegations of the Byelorussian Soviet Socialist Republic, the People's Republic of Bulgaria, the Czechoslovak Socialist Republic, the German Democratic Republic, the Hungarian People's Republic, the Mongolian People's Republic, the Polish People's Republic, the Ukrainian Soviet Socialist Republic and the Union of Soviet Socialist Republics on the restructuring of international economic relations on a just, equal and democratic basis" (A/38/479, annex), para. 2.

28/ Ibid.

29/ See the proposal submitted by the German Democratic Republic on behalf of Group D (TD/L.230); reproduced in Gemeinsame Erklärungen sozialistischer Staaten zu Fragen der Umgestaltung der internationalen Wirtschaftsbeziehungen auf demokratischer Grundlage (Berlin, Ministerium für Auswärtige Angelegenheiten, 1983), pp. 1-16.

30/ Reply of the Government of Poland to the Secretary-General's questionnaire concerning General Assembly resolution 39/218 on development and international economic co-operation; a similar argument can be found in the reply of the Government of the German Democratic Republic. Both Governments strongly agree with the position taken in the CMEA statement referred to in note 18 and in the Nairobi statement.

31/ China and Romania do produce some significant quantities, but the output is small relative to that of the USSR.

32/ For a comprehensive review of the evolution of the USSR stance on gold, see Alain Rémy, "Le rôle de l'or dans l'économie monétaire occidentale: analyses soviétiques" (Paris, Université de Paris I - Panthéon-Sorbonne, Thèse de 3ème cycle, octobre 1981, miméographié); and Alain Rémy, Un retour à l'or? Analyses soviétiques sur le système monétaire international (Paris, Economica, 1985).

33/ The socialist countries normally take a rather absolute view of monetary sovereignty (see, for instance, Hans Spiller, Finanz- und Währungsbeziehungen zu nichtsozialistischen Ländern (Berlin, Staatsverlag der Deutschen Demokratischen Republik, 1984), pp. 28-31.

34/ See, for instance, I. Korolev, "Mirovoy kreditny krisis", Mirovaya ekonomika i mezhdunarodnye otnoshenia (Moscow) No. 9 (1984), pp. 36-47.

35/ "Joint statement of the delegations of the Byelorussian Soviet Socialist Republic, the People's Republic of Bulgaria, the Czechoslovak Socialist Republic, the German Democratic Republic, the Hungarian People's Republic, the Mongolian People's Republic, the Polish People's Republic, the Ukrainian Soviet Socialist Republic and the Union of Soviet Socialist Republics on the restructuring of international economic relations on a just, equal and democratic basis" (A/38/479, annex), para. 2.

36/ See Mária Brüll, Pénzgazdaság - világgazdaság (Budapest, Közgazdasági és Jogi Könyvkiadó, 1983), p. 188.

37/ This aspect is emphasized in Georgy G. Matyukhin and V. Shenaev, "Novaya valyutnaya sistema i uroki Bretton-Vudsa", Mirovaya ekonomika i mezhdunarodnye otnoshenia (Moscow), No. 6 (1978), p. 50.

38/ For an explicit statement to that effect, see Stanislaw, Raczkowski, "The international monetary crisis and the socialist countries", The International Payments Crisis and the Development of East-West Trade (Brussels, Etablissements Emile Bruylants, 1977), pp. 94-95. See also V. Acharkan, "Valyutnye kursy - mekhanizm formirovania i mezhimperialisticheskie protivorechia", Mirovaya ekonomika i mezhdunarodnye otnoshenia (Moscow), No. 9 (1984), pp. 72-82.

39/ Georgy G. Matyukhin, "Novaya forma mirovykh deneg", Mirovaya ekonomika i mezhdunarodnye otnosheniya (Moscow), No. 4 (1977), p. 162.

40/ For an interesting proposal that envisages a trade-off between official development assistance by and SDRs for the socialist countries, see Sidney Dell, "International monetary reform and the socialist countries", The Banker (London), No. 2 (1970), pp. 158-165.

41/ Spiller, op. cit., p. 43.

42/ Yuri A. Konstantinov, "Valyutno-kreditnye osnoshenia stran-chlenov SEV s razvivayushchimisya stranami", Finansy SSSR (Moscow), No. 3 (1982), p. 60.

43/ Financial Times (London), 12 September 1985, p. 6.

44/ See Imre Lantos and Hajna Lörincné Istvánffy, A nemzetközi valutáris kapcsolatok fejlödésének új tényezöi (Budapest, Közgazdasági és Jogi Könyvkiadó, 1979), p. 227.

45/ The USSR might find it politically unacceptable that the United States, by virtue of its 19.3 per cent voting share, has the veto power while the USSR would not have it.

46/ See, in particular, section 7 of the CMEA Comprehensive Programme for Socialist Economic Integration (as reproduced, for instance, in Mnogostoronnee ekonomicheskoe sotrudnichestvo sotsialisticheskikh gosudarstv - sbornik dokumentov, Praskovia A. Tokareva, Mikhail D. Kudriashov and Vasily I. Morozov, eds. (Moscow, Juridicheskaia literatura, 1972), pp. 58-64.

47/ For a detailed analysis of the "traditionalists" and "modernists", as Marie Lavigne categorizes them, see Lavigne, loc. cit., pp. 373-376.

48/ Oleg S. Bogdanov, Valyutnaya sistema sovremennogo kapitalizma (Moscow, Mysl', 1976), p. 116.

49/ Lidia N. Krasavina, "Diskussia o roli zolota v mezhdunarodnykh ekonomicheskikh otnoshenia", Voprosy ekonomiki (Moscow), No. 2 (1978), p. 145.

50/ For a representative position, see Georgy G. Matyukhin, "The role of gold in the future monetary system", Money and Finance in East and West, op. cit., pp. 243-249.

51/ Tamás Bácskai, "Währungspolitische Diskussionen in den sozialistischen Ländern", Europäische Rundschau (Vienna), No. 4 (1975), p. 22.

52/ See the report of the all-union conference on the issue by Lidia N. Krasavina and E. Baranova, "Aktualnye problemy mezhdunarodnykh valyutno-kreditnykh otnoshenia", Dengi i kredit, (Moscow), No. 6 (1984), pp. 72-78.

53/ Stanislav M. Borisov, Zoloto v ekonomiki sovremennogo kapitalizma (2nd ed., Moscow, Finansy i statistika, 1984), p. 449.

54/ On the eve of the sixth session of UNCTAD (Belgrade, 1983), two senior officials of the Ministry of Foreign Trade of the USSR examined a number of aspects of the international monetary system as they related to the forthcoming meeting. One of them, the Deputy Minister for Foreign Trade, while not touching on the central monetary issues, reaffirmed the suitability of UNCTAD as a "universal international organization", which should devote due attention to the importance of international monetary problems (see Aleksey Manzhulo, "Shestaya sessia YUNKTAD: tseli i zadachi", Vneshnyaya torgovlya (Moscow), No. 4 (1983), p. 17). The other, a senior expert of the Ministry's Department of International Economic Organizations said that the socialist countries "did not consider the attempts to restrict artificially the role of gold in the international liquid resources as substantiated, especially under the constant inflationary devaluation of paper money" (see Aleksandr Samorodov, "YUNCTAD-VI i valyutno-finansovye problemy", Vneshnyaya torgovlya (Moscow), No. 5 (1983), p. 39), but he did not revert to any stronger position on international monetary reform which, at the time, was a central issue of the global negotiations and international monetary conference under discussion.

55/ It is important to note that the variants have never been discussed as viable alternatives in USSR literature; they have been mentioned only briefly in some Eastern European literature and in statements by policy makers.

56/ Changes have also had to be made with regard to China's role in the Fund and the Bank. China, however, has not recently had a need for structural adjustment policies.

57/ Proceedings of the United Nations Conference on Trade and Development, Fourth Session, vol. I, Report and Annexes ..., annex VIII, sect. E, para. 24.

58/ Franklyn D. Holzman, "Comments", Money and Finance in East and West, Christopher T. Saunders, ed. (Vienna and New York, Springer-Verlag, 1978), pp. 126-127.

59/ János Fekete, "Monetary and financial problems in East and West", Money and Finance in East and West, Christopher T. Saunders, ed. (Vienna and New York, Springer-Verlag, 1978), p. 27.

60/ For a summary of the views, chiefly of the "modernists", see Fomin, loc. cit., pp. 108-109.

THE CHANGING INSTITUTIONAL CHARACTER OF INTERNATIONAL FINANCIAL MARKETS IN THE 1980s*

CONTENTS

INTRODUCTION

International financial markets, while located primarily in the major developed market economies, have served as a main conduit for financial transfers to and from all groups of countries. The growing depth and complexity of these markets, as well as their growing inter-linkages, have had global implications for economic growth, stability and development, especially in recent years. Since the late 1960s, the markets have been undergoing major changes in how they operate and whom they serve. In the early 1980s, however, the process of change took a new direction and the rate at which innovations have been absorbed appears to have accelerated. The purpose of the present paper is to outline the main characteristics of these innovations and the reasons for their emergence. The question of their implications for policy is also posed.

The root causes of innovation through the late 1970s were technological advances and an increasingly volatile interest rate and exchange rate environment. The risks and rewards of short-term financial management provided incentives to create new technologies and more aggressive trading practices. By the end of the 1970s most large institutions in the major developed market economies, including non-financial corporations and many government authorities even at the municipal level, had established financial trading rooms stocked with sophisticated electronic communication and trading devices and staffed by specialized traders.

Aside from the application of advances in electronic data processing and communications, the major innovations of the 1970s were designed to circumvent regulatory restrictions and taxes. In domestic markets, new devices like

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"repurchase agreements" and institutions such as those that offered "checkable" mutual fund shares circumvented interest rate ceilings on deposits. Many banking operations were booked "offshore" to escape regulatory restraints and to avoid tax liabilities.

Regulatory authorities, powerless to prevent many of the circumventions and in recognition of the market distortions that were developing, lifted many of the restrictions that had given rise to circumvention and reduced taxes on financial intermediation. As a result, innovations became less of the circumventive type and to a greater extent reflected heightened incentives facing financial institutions, particularly commercial banks that sought to regain ground lost to their less regulated competitors.

The first section below reviews the important changes in instruments and practices that have taken place in the 1980s. The second section presents comments on the implications of those changes for the integration of international financial markets, and a discussion of the consequences of the changes with respect to access of certain borrowers to credit, the fragility of the international financial system, and the functioning of domestic macro-economic policies.

THE NEW ROLE OF SECURITIES IN INTERNATIONAL FINANCE

The most noteworthy innovative trend since the early 1980s has become known as the "securitization" of financial markets - that is, financial intermediation is more and more channelled through the issue and purchase of marketable securities rather than by the banking mechanism of deposit-taking and lending. The phenomenon would have developed eventually for many of the reasons that will be cited here and in the annex below, but much more gradually had it not been for a set of circumstances that arose around the time of the Mexican payments crisis in August 1982. The questions this event raised about the viability of many of the largest banking institutions led to an abrupt reversal of the relaxed lending attitudes banks had had towards developing countries. It also created a general awareness on the part of banks of the risk of lending to more vulnerable borrowers and, on the part of bank depositors, of the safety of their funds. Banks found themselves having to pay more for funds while the lucrative outlet for earnings from loans to many developing countries now seemed too risky to undertake except within the context of debt rescheduling and adjustment. 1/

The difficulties of banks were compounded by a world-wide shift in the sources of liquidity associated with the sharp drop in current-account surpluses of major oil exporters - which had been a major source of bank deposits - and, more generally, with the effect of the post-1982 world economic recovery on the liquidity positions of corporations and pension funds. The sources of liquidity became concentrated in the hands of sophisticated portfolio managers of pension funds, insurance companies, and non-financial corporations, which tended to avoid direct bank liabilities. Moreover, the pool of accepted borrowers became concentrated in high-quality ones such as relatively liquid corporate and sovereign entities, not to mention the United States Government. 2/ The resulting restricted market in syndicated credits accounts in part for the significant drop, in 1984, in average spreads above the London Interbank Offered Rate (LIBOR) in international loans to States members of the Organisation for Economic Co-operation and Development (OECD) and of the Organization of the Petroleum Exporting Countries (OPEC) (see table 1). 3/

Table 1. Spreads on international bank loans, 1979-1985

("Basis points" - one hundredths of a percentage point - above the London Interbank Offered Rate)

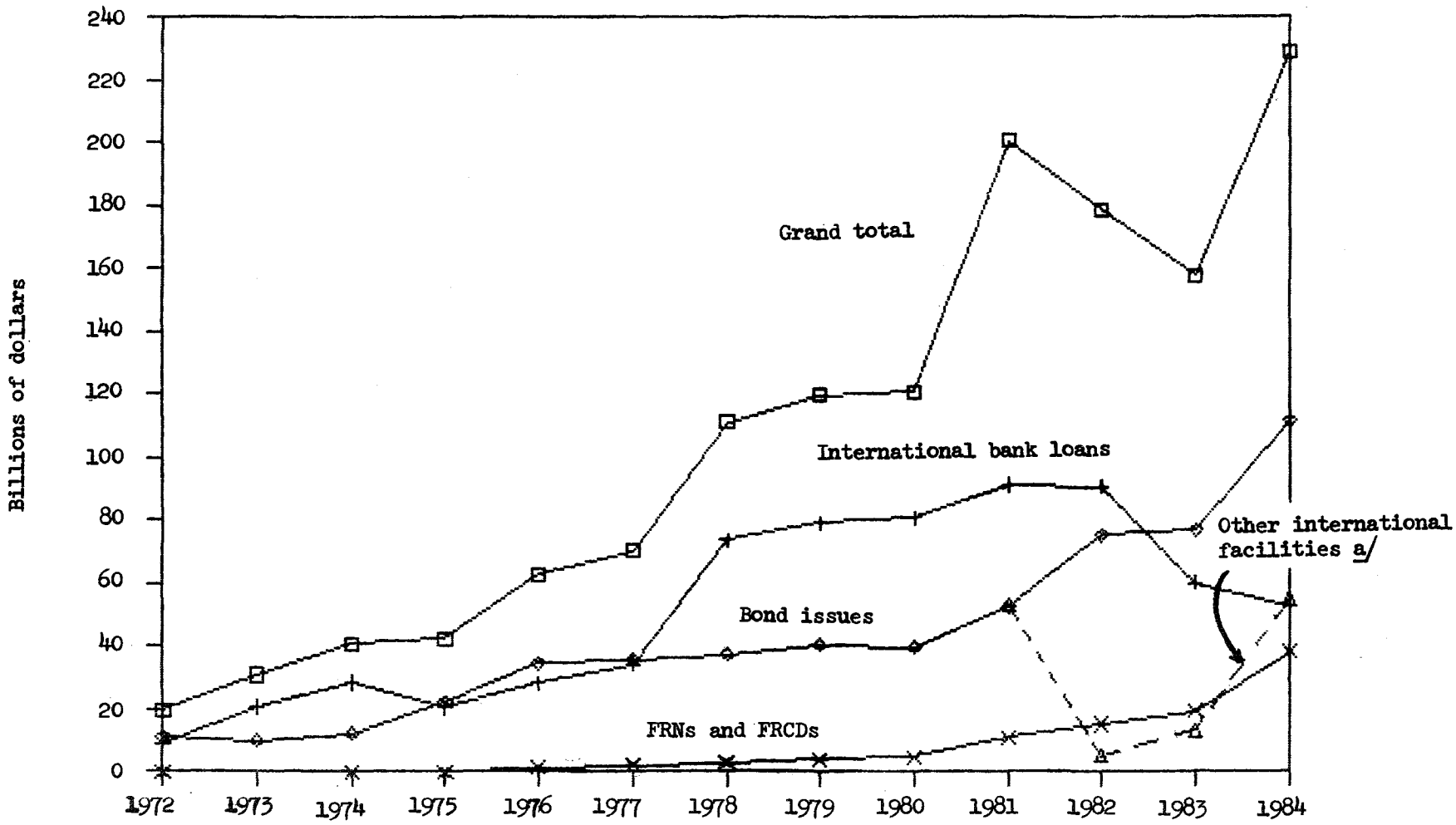
	1979	1980	1981	1982	1983	1984	January-May 1985
Developed market economies	62	59	58	56	65	55	43
Eastern Europe and the USSR	70	88	62	103	118	88	59
OPEC countries	105	77	79	94	85	76	60
Other developing countries	85	91	104	114	170	144	115

Source: Organisation for Economic Co-operation and Development, Financial Market Trends, June 1985 and previous issues.

Policy developments have also contributed to this trend. In 1984 and 1985, the Federal Republic of Germany, Japan and the United States of America, eliminated withholding taxes on interest payments to foreign residents, leading to a greater degree of tax uniformity. Further, those same years saw significant liberalization of banking and primary securities markets in France, the Federal Republic of Germany and Japan. Demands for reciprocity have threatened to retard the liberalization process, but ultimately - assuming reciprocity is granted - the process will be extended.

The simultaneous cut-back in traditional bank lending and burgeoning of activity in international securities markets is illustrated in figure I. 4/ To a significant extent, this shift was the consequence of (a) the tendency of securities to outpace loan finance when interest rates are low and (b) the drop in credit to developing countries, most of which takes the form of syndicated loans (whereas non-developing country intermediation has been more evenly financed by securities). This latter point notwithstanding, the bulk of the world-wide shift from international loans to securities is accounted for by borrowers other than the non-oil developing countries (see figure II).

Figure I. International credit and security arrangements, 1972-1984

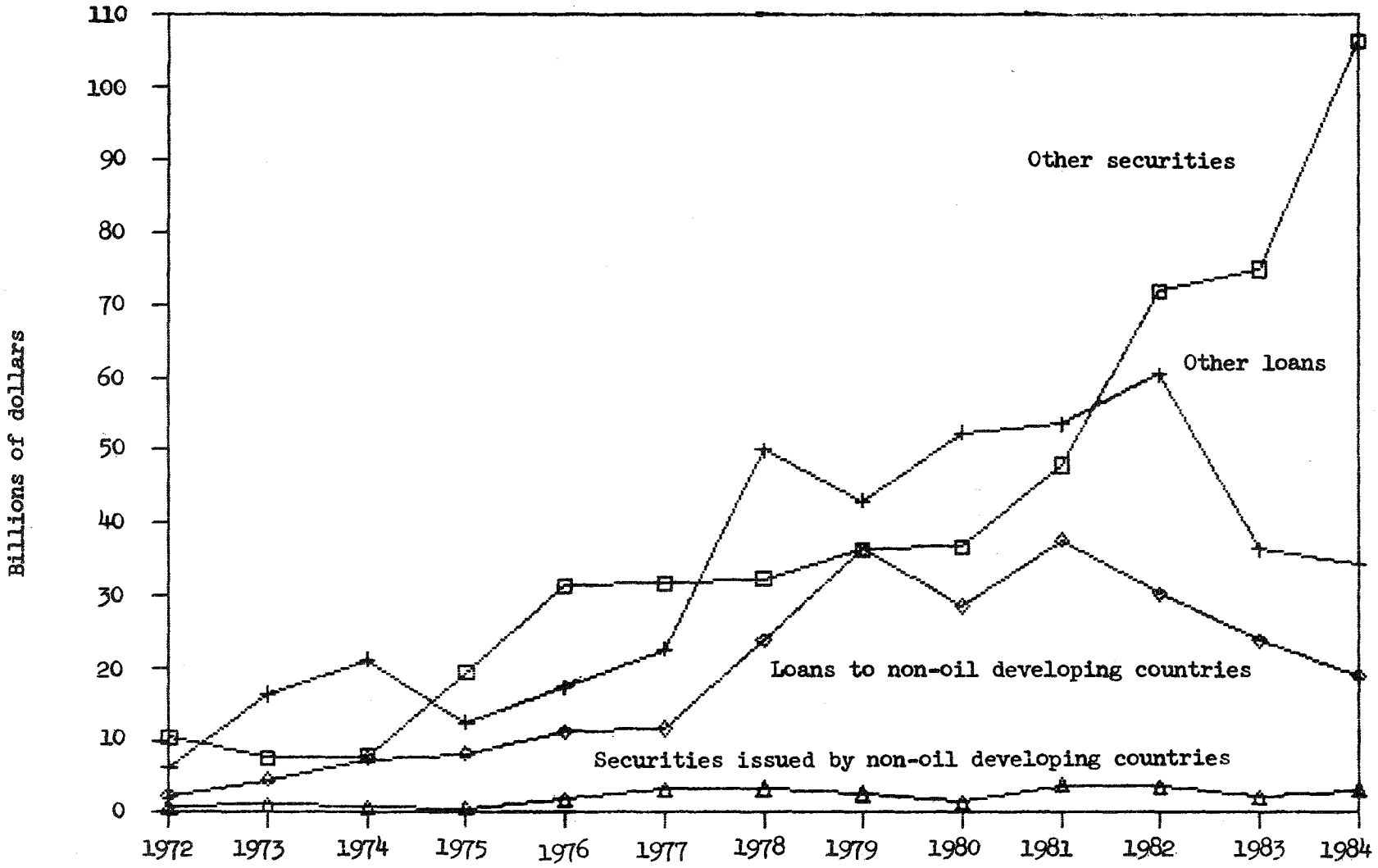


Source: Organisation for Economic Co-operation and Development, Financial Statistics Monthly, Section 1: International Markets, various issues.

Note: FRNs: floating rate notes; FRCDs: floating rate certificates of deposit.

a/ Note Issuance Facilities and the like; before 1981 they were included in "International bank loans".

Figure II. Loans and bonds: developing countries and other borrowers, 1972-1984



Source: Organisation for Economic Co-operation and Development, Financial Statistics Monthly, Section 1: International Markets, various issues.

Not revealed in the aggregate figures are two more subtle forms of securitization: (a) changes in the role of banks from "guardians of credit" to a role more closely akin to investment banking; and (b) blurring of conventional distinctions between securities finance and syndicated lending, banks and other institutions creating loans similar enough to securities to be traded in secondary markets and issuing securities with many of the special features that in earlier years could only be found in syndicated loans. The major innovations are floating rate notes (FRNs), off-balance-sheet back-ups such as Note Issuance Facilities (NIFs), interest rate swaps, and resale of debt in new secondary markets. 5/

Floating rate notes

With the squeeze on earnings, banks have been forced to participate directly in the securitization process. For example, they have become major purchasers and issuers of FRNs. These instruments are medium-term to long-term securities paying interest at a rate that is adjusted at three-month or six-month intervals in relation to a reference rate (most often LIBOR). The securities are listed on stock exchanges, though the market is almost entirely conducted by telephone or telex. They have been bought by banks as a means of extending credit to other banks as well as corporations and sovereign Governments. Their marketability gives them more liquidity than the holding of interbank deposits and thus enhances the capacity of banks that hold them to adjust asset exposures. FRNs also preserve the variable rate protection typically part of a syndicated loan agreement. To a significant degree, banks have been obliged to lend in this form to high-grade borrowers who could otherwise raise funds directly in this market and obtain its fine terms. Banks have also been issuing FRNs as a means of attracting funds because competition has required that they offer a marketable instrument to substitute for traditional Euro time deposits.

Regulatory factors have also been important. After competitive pressures extended maturities on bank credits, FRNs have allowed banks to extend the maturity of their liabilities without a corresponding increase in interest rates. Moreover, some monetary authorities have established conditions under which liabilities created by FRNs can be treated as primary or secondary capital, a particularly salient issue given the concern in recent years about the degree to which banks have an adequate capital base.

As a result of these competitive and liquidity features, FRNs have begun to replace a significant portion of the traditional interbank-deposit placement markets. In addition, in 1984 and 1985 a greater share of FRNs was issued by non-bank corporations and Governments, leading to a trend to price securities in terms of money market rates rather than LIBOR.

Off-balance-sheet banking

Banks have also contributed indirectly to the securitization of financial markets in the 1980s through their participation in back-up facilities for securities issuance. Just as banks in the United States supported the domestic commercial paper market in the 1960s and 1970s, international banks have created back-up facilities such as Note Issuance Facilities (NIFs). For a fee, the bank facilitates rollover of a short-term Euronote (or commercial paper in the United States) by agreeing either to purchase unsold notes at a pre-arranged rate or to

provide a stand-by loan. The back-up in effect makes the borrower's short-term note longer term, and generally cheaper than a longer-term credit would otherwise be because of (a) the shorter maturity, (b) the wider range of potential buyers and (c) the guarantee that there will not be a glut of paper near the rollover date. The banks avoid direct balance-sheet exposure, facing instead the risk that the commitment will be called upon. The risk of that happening is significantly reduced by the knowledge market-wide of the support that the borrowers have from the facility itself. However, the commitment can be called upon at any time. This is most likely to happen when a borrower's creditworthiness becomes doubtful.

The volume of NIFs and similar back-up facilities picked up considerably in 1984 (see table 2), although the figures may be distorted because of back-ups created for United States merger activities. 6/ The facilities in the table are commitments to back up issues and not funds drawn down. Recent evidence shows that only a fraction of the commitments, probably of the order of one quarter to one third, have actually been used.

Table 2. International back-up facilities, 1981-1984

(Billions of dollars)

	1981	1982	1983	1984
Commitments to back up issues of:				
Euronotes	3.2	2.2	0.8	8.8
Commercial paper	3.4	0.2	3.1	3.5
Certificates of deposit	0.2	0.7	2.8	1.1
Bankers' acceptances	6.9	2.0	1.8	5.8
of which sterling	(2.2)	(1.5)	(1.3)	(1.1)
Other instruments	0.3	0.3	1.0	1.9
Multiple component facilities	-	-	-	7.7
Sub-total	14.0	5.4	9.5	28.8
Merger-related stand-bys	39.1	-	4.0	26.5
Total	53.1	5.4	13.5	55.3

Source: Organisation for Economic Co-operation and Development, Financial Market Trends, June 1985 and previous issues.

Interest rate swaps

Commercial banks, and to an increasingly greater extent investment banks, have become heavily involved in interest rate swaps. The technique, a variant of exchange rate swaps, 7/ is one in which two borrowers, usually through a bank intermediary, agree to meet each other's interest obligations (although each continues to make its own payment of principal). The classic example, still responsible for the most volume, is where a well-known bank that has a comparative advantage in issuing fixed-rate debt agrees with a non-financial firm seeking fixed-rate debt to exchange fixed and variable interest obligations. In that way, the non-financial firm gains access to fixed-interest credit to which it otherwise has no access and the bank matches variable interest debt to its variable-interest credits. There are a variety of ways in which the two participants (or counter-parties) negotiate and share the interest savings, including an adjustment in the levels of the two interest payments exchanged over time or a lump-sum adjustment. Since 1983, a large number of variants have been offered, including swaps of floating rate commitments, swaps in interest denominated in different currencies, swaps between non-financial counter-parties, and swaps between banks.

Making loans marketable

For several reasons, banks have created markets in syndicated loans both for swap and for cash sale. The market is small at present but promises to become a major innovation in bank portfolio management. The capacity to sell loans provides banks with flexibility in managing risk relative to capital. Further, the more highly developed a secondary market, the closer loan creation can come to off-book securities underwriting. The major impediment to creating an active secondary market with existing loans is that resale usually requires the consent of the borrower. Some new syndicated loans have been arranged with "transferability", but, according to Bank of England estimates, only about $1.5 billion of them were created in 1984. 8/ Loan sales including those with transferability probably totalled $6 billion to $10 billion in 1984.

On a more limited scale, a number of banks have succeeded in selling "non-performing" loans, usually on a swap basis at par value to avoid revealing cash discounts. 9/ There is a nascent secondary market in which dealer-broker activities are dominated by one large United States bank.

COSTS AND BENEFITS OF THE INTERNATIONAL INTEGRATION OF FINANCIAL MARKETS

The accelerating process of securitization is substantially tightening the integration of major domestic and international financial markets. In addition, as banks become less necessary as a financial intermediary, access to credit is becoming less limited with respect to location or origin, denomination of currency, and instrument by which credit is extended. In effect, "access" is being marketed and at increasingly competitive prices. As the market becomes more standardized and liquid, the investment banks are capturing a greater part of the underwriting side of the business. The trend is also for commercial banks to be relegated to the higher risk end of the market. Central banks are casting a wary eye on market exposures of banks and taking actions that are raising the cost of facilities supported by commercial banks relative to those arranged through investment banks.

In the banking sector, both enhanced prudential controls over banks and deregulation of the type that has increased competition have reduced returns available in conventional banking. In contrast, earnings opportunities in the securities markets have attracted substantial entry of new competitors in various countries since 1983.

It is probably too early to describe the major international capital markets as being fully integrated, but several factors in the past three years illustrate how far the trend has come. First, firms in the United States have been borrowing heavily in foreign markets on account of the favoured status and the lower borrowing costs they found in the Euromarkets. One response to this increase in competition among domestic capital centres has been the pricing of some United States domestic loans at LIBOR and at the same time the pricing of some Eurocredits and securities involving non-United States entities in terms of United States money market rates. Some international clearing arrangements on futures exchanges have also arisen. "Tricentral" presence (i.e. presence in London, New York and Tokyo) has become an important component in the competitiveness of financial firms. In 1985, several security issues were undertaken simultaneously in all three centres.

While to the disadvantage of most commercial banks, securitization of financial markets has provided significant pecuniary benefits to participants. Intermediation takes place at lower cost and with greater liquidity across markets. Risk exposures can be diversified better and managed more flexibly, and wider access to funding reduces much of the risk to medium-term lending exposure.

In three principal cases, however, highly "fluid" capital markets pose problems at the level of national economies: (a) restricted access to credit for certain types of borrowers, (b) prudential activities of commercial and investment banks, and (c) the effective and autonomous functioning of macro-economic policy.

Credit access

One area of critical concern is the impact of securitization on the access of higher-risk borrowers to the international credit markets. It seems inescapable that a key factor behind securitization is the homogeneity of agents who participate in it. Intermediation through securities works best where instruments can be standardized and where risk characteristics are uniform. Indeed, a reason for the expanded share of securities markets in total lending activity is the reduced access to credit of any type of higher-risk borrowers. The period since 1982 has been one of a high-quality borrowers' market - a market most conducive to securities intermediation.

The other forces leading to securitization - technology and financial sophistication - have different implications for access of different groups of borrowers that have been excluded from securities markets in the past. On the one hand, the potential scale and resulting diversity in forms of credit may provide avenues for entry to the market for at least some borrowers. These borrowers may also benefit from competitive pressure on commercial banks to undertake securitization activities such as marketable loan packages, interest swaps and back-up facilities for borrowers that are perceived as the less risky among the higher-risk countries. 10/

On the other hand, much of the financial innovation discussed above has been leading towards standardizing contracts and homogenizing the selection of participants. It is inevitable, therefore, that some borrowers - in particular those developing country Governments and larger private sector borrowers that have had difficulties recently in making debt-servicing payments - will be excluded from the markets for some time even after their debt difficulties are resolved. It seems unlikely that securitization will work to the net disadvantage of these borrowers, but their unique and somewhat unfavourable borrower classifications will continue to make them dependent on "concerted" syndicated loans and official sources of credit for some time to come.

Public institutions such as the World Bank could conceivably expand their now limited underwriting activities on behalf of developing countries in the FRN market to issuance facilities and interest swaps. A possible model is the "market-making" activities in interest rate swaps currently employed by the United States Federal Home Loan Bank Board. Under this arrangement United States thrift institutions can swap variable rate liabilities for liabilities whose rates are less frequently adjusted in order to better match the interest-rate structure of their mortgage portfolios.

Prudential concerns

A second economic problem posed by securitization involves the prudential concerns that arise as part of the shift from traditional risk-management by a relatively small group of international banks, operating under official supervision, to an impersonal, "market" discipline in a securities market that is largely uncontrolled, particularly in the secondary market. It is often argued that improvements in technology and communications, sophistication of borrowers and lenders, and associated competition are fast making traditional modes of banking obsolete. Whereas half a decade ago large credit transactions nearly always required centralized design or management on the part of a small group of specialist banks which would parcel out participations to smaller banks or distribute securities, today many of the same transactions are accomplished with "bought deals" where banks, but more frequently a large group of investment banks, bid at auctions for borrower-designed paper, which they sell to a wider market. Heightened sophistication and market-risk awareness must have contributed to these changes.

One consequence is that financial markets might become more fragile. If so, the world economy will face greater risks of financial crisis, as well as frequent limitations on the options available to policy makers. One issue is the age-old consideration of the wedge between social and private risk perception that frequently arises in credit markets. Agents maximizing private goals, particularly in competitive situations, will in general engage in credit activities which collectively lead to excessive systemic risks which they see (correctly) as independent of their actions in isolation.

A second issue is that, among the reasons for securitization, an important one is the changed approach of policy towards financial markets, entailing both deregulation (lifting deposit ceilings, permitting banks and non-banks to engage in greater competition) and tighter regulatory policies in respect of capital requirements and exposures. Together these have worked to the disadvantage of commercial banking institutions, especially the traditional forms of credit intermediation by commercial banks. Recent prudential measures, such as

introducing capital requirements on the NIF type of back-up and on interest swap activities, and other supervisory measures have also been concentrated on commercial banks. As a result, unregulated investment banks can offer a comparable service at lower cost, which tends to push the business outside the net of existing supervisory control. At the same time, as banks need to charge higher fees to cover their higher costs, they are led to concentrate on borrowers whose perceived riskiness tends to exclude them from the lower-priced market.

These trends threaten to make the financial markets more fragile. In other words, since official supervision of international financial markets is primarily undertaken by banking authorities, a greater degree of regulatory activism of these authorities accelerates the growth of the unregulated part of the market. This, in turn, reduces the share of the total market which is under regulation, thereby inhibiting the overall control and surveillance activities which are the responsibility of central banks.

Integrated capital markets and autonomous macro-economic policy

As the latest phase in the increasing integration of financial markets, the process of securitization is perhaps adding a further impetus to the shrinking autonomy of macro-economic policy in major countries. Tighter financial integration increases the capacity of local interest rate changes to attract or repel flows of funds. This enhances the power of monetary policy to influence capital flows and exchange rates. Ironically, the increased power in most cases has been accompanied by more restraint on its use. Effective exchange rate management requires that each country employ its monetary policy appropriately and within narrow limits of latitude. It becomes more difficult to "sterilize" exchange rate intervention activity. 11/ Indeed, countries have been reluctant to subordinate domestic policies to external goals.

To aggravate the policy problem further, there is substantial empirical research to support the hypothesis that, other things being equal, domestic deregulation tends to reduce the interest-sensitivity of the demand for domestic monetary aggregates. This is because rates offered on components of the monetary aggregates are freer to move in tandem with securities market rates and this reduces the incentive to switch from these liabilities to securities and other investments. With central banks maintaining stricter targets for monetary aggregates - a trend particularly important since the late 1970s - domestic interest rates have tended to change by larger amounts in response to substantial shifts in money demand and the other factors that cause sharp expenditure changes.

In these circumstances, high degrees of international capital fluidity have an implication not widely recognized. Not only do local shocks now tend to produce sharper interest rate movements, but they also tend to be dissipated quickly as financial investors move funds across borders to take advantage of the interest differentials. For example, a domestic shock raising local interest rates will mobilize a compensatory external capital inflow that will alleviate credit conditions internally. However, this very process accentuates the problem of the cross-border transmission of shocks, as individual domestic markets are more exposed to foreign shocks whose impact on foreign interest rates are now larger. Domestic shocks in one country thus reduce the policy discretion in partner countries. At the same time, the consequences of policy errors in one country may be moderated by international capital flows, providing something of an escape valve at least temporarily. Indeed, the growing recognition of the inherent instability

of this process underlies efforts begun in 1985 to intensify the co-ordination of macro-economic policies among the major market economies.

Notes

1/ Where the withdrawal of lending to higher-risk borrowers was not a "market" phenomenon, it was imposed by stricter regulatory stances arising in most countries after 1982, especially in the Federal Republic of Germany and the United States of America. In the United States, congressional authorization of an increase in the IMF quota in 1983 was accompanied by the International Lending Supervision Act, which included provisions for (a) prudential reserves, (b) increases in requirements for disclosure of large concentrations of international lending at banks, (c) increased frequency of reporting country exposures and (d) tightened policy guidelines for capital adequacy of large United States banks. In the Federal Republic of Germany, a banking act made effective beginning in 1985 requires consolidation of accounts of domestic and foreign subsidiaries upon which capital minimums of one eighteenth of assets are to be applied and improves statistical coverage.

2/ Indeed, some of the largest corporate and sovereign borrowers in the United States market in 1984 and 1985 had Standard and Poor's AAA ratings while only one United States international bank holding company maintained such a high rating.

3/ The spreads on loans to non-OPEC developing countries, while still disproportionately high, also fell, partly as a result of debt restructuring and partly because of regulatory changes.

4/ The figures shown in figure I represent credit commitments rather than credit actually transacted. The "spike" in the 1981 "Grand total" figure reflects a sharp jump in merger-related credit arrangements, most of which were not called upon.

5/ Institutional details which supplement the following discussion are provided in the annex below.

6/ Whether these should be excluded from the figures is a controversial issue. It probably makes more conceptual sense to think of recent merger activity as an "exogenous" phenomenon in financial markets worthy of separate discussion, while the growth of NIF-backed credit for more conventional purposes is part of the more general story of financial market innovation.

7/ The term "Exchange rate swaps", as commonly used in foreign exchange markets, refers to the simultaneous sale and purchase of foreign exchange spot and forward which allows borrowers, lenders, and arbitrageurs to choose the most profitable interest rate combinations (among instruments having different currency denominations) at low risk. In the present context, the term refers to the device of trading entire obligations - principal and interest - denominated in different currencies, which is a phenomenon that arose in the 1970s.

8/ Bank of England, Quarterly Bulletin, March 1985, p. 61. This estimate may understate the total by several billion dollars since it apparently excludes a transferable "bank advance facility" contained in a $4 billion multi-component facility arranged by the Government of Sweden in 1984.

Notes (continued)

9/ Realization of a price less than par may, under current accounting practices, require a write-down of the swapped loans. In addition, the Federal Reserve may impose special reserves on the assets involved, which it is empowered to do under the International Lending Supervision Act of 1983.

10/ For example, such countries as India, Malaysia and Thailand have recently arranged to borrow by means of Note Issuance Facilities.

11/ For example, to support its exchange rate a central bank may purchase the local currency with foreign currency. The reduction in the local country's monetary base usually implies higher interest rates in the short-run which, with mobile capital, will attract foreign investment and drive up the currency price. Indeed, with an efficient enough capital market this may be the main force underlying the strengthening of the domestic currency. If the central bank wishes to neutralize the monetary effect domestically, it may "sterilize" it through expansionary monetary policies that reduce interest rates but, with fluid enough capital markets, this will nullify the exchange rate effect.

Annex

NEW INSTRUMENTS AND PRACTICES IN THE 1980s: THE SALIENT CHARACTERISTICS

Floating rate notes

Floating rate notes (FRNs) were first introduced in the early 1970s to enlarge borrower access to credit. The instruments shifted the risk to borrowers from lenders who were unwilling to bear the risk of holding fixed-rate securities in an increasingly volatile interest rate environment. Many non-bank borrowers also had "name problems" (i.e., they were not well known in financial markets) and the use of floating rates gave their liabilities a compensating appeal. Banks in particular saw the value in purchasing them to match their variable-rate liabilities. FRNs had another advantage in that regulations limiting loans often did not apply to securities and FRNs were sometimes useful in circumventing those regulations. FRNs had certain drawbacks, however, compared with syndicated loans because they did not give the borrower so many options. a/ Where the use of FRNs did grow, it tended to be, in effect, a disguised syndicated loan, capitalizing on regulatory advantages but not yet offering the liquidity to investors that could be brought about only by standardization.

The coming of age of FRNs had to wait until the early 1980s (see the table). By 1984 their volume for the first time exceeded that of fixed-rate issues. Initially, the dominant spur to growth was the aversion certain investors had to holding bank deposits after the well-publicized difficulties major banks were having with loan portfolios. An additional factor was the newly found liquidity in the hands of sophisticated institutional investors.

Characteristics of floating rate notes, 1978-1984

	1978	1979	1980	1981	1982	1983	January-November 1984
Number of issues	27	56	48	65	81	60	148
Average margin over LIBOR (basis points)	39	31	24	27	25	16	14
Average maturity (Years) 9.7	9.7	8.0	8.5	9.6	10.3	12.4	
Average size (millions of dollars)	58	57	74	90	129	17	189

Source: Maggie Urry, Financial Times, 18 March 1985, based on data supplied by Merrill Lynch.

Many banks found that in order to compete for funds they could not rely only on deposits but also had to offer the liquidity of marketable securities and market these securities aggressively. It was particularly important to banks to sustain the maturities of their liabilities as competitive conditions dictated that they offer their own loans at longer maturities. French and Japanese authorities actually require a matching of liabilities against a portion of assets, which creates a demand for longer-term funds. Partly as a result, French and Japanese banks have been dominant among bank issuers of FRNs. Moreover, French lending controls have not applied to lending financed by bond issues, and FRNs can sometimes be counted as capital in the United Kingdom of Great Britain and Northern Ireland, the United States and other countries. b/

A high percentage, perhaps 80 per cent, of bank-issued FRNs are held by other banks, suggesting a trend towards displacement of the interbank deposit market. Securitized claims are more liquid than traditional interbank Euro time deposits, and they provide more flexibility in adjusting liabilities to the exposure of assets. Thus, United States savings and loan associations have become major non-bank holders of FRNs, using them to match maturities of their "Super NOW" and money market deposit account liabilities, which carry market rates of interest.

By late 1985, FRNs had become a major alternative to syndicated bank loans, in fact already replacing a significant portion of the syndicated credit market. High-quality sovereign borrowers in particular have found the costs of borrowing through FRNs substantially less than in the syndicated loan market. Their "jumbo" issues, which have exceeded $1 billion, have revealed themselves to be highly liquid in the secondary markets. Recent issues of high-quality sovereign and corporate borrowers found banks in competition with other investors to buy and hold the issues, and have driven spreads to within a few basis points above LIBOR. Borrowing through FRNs has been substantially more popular with sovereign than corporate borrowers, as corporations have variable short-term cash needs which can be managed more efficiently using stand-by credits with multicurrency facilities.

Some recent "hybrid" FRNs - those containing tailored characteristics typically associated with syndicated loans - are effectively making securities out of what, from the borrowers' point of view, are close substitutes for syndicated loans. It is interesting to note that whereas in the early 1970s syndicated loans were mandated by the size of many credits, today, with FRNs, a collection of lenders is again channelling credit to borrowers but through a more indirect, more market-oriented process. Much of the credit is still coming from the banks but, increasingly, the banks are buying and selling securities in a market rather than themselves directly intermediating the transaction.

One indicator of this phenomenon can be found in recent changes in the pricing of the instruments. Some large FRNs have recently been issued with reference rates different from LIBOR. Since 1982, when the World Bank started pricing its issues in terms of United States short-term rates, there has been a growing tendency to offer other reference rates such as Libid, Limean, c/ or that on United States Treasury bills. In some recent issues the traditional three- and six-month rate adjustment has been bypassed in favour of more frequent adjustments. In 1985, a "mismatch" formula was used, in which a three- to six-month rate was adjusted each month. The purpose was to attract funds from institutions that had been increasingly cautious about the direction of interest rates to borrowers needing long-term commitments. d/ The "mismatch" permitted FRNs to be held profitability in the secondary market at a positive "carry" (spread over financing cost). e/

Despite their active participation, commercial banks find themselves at a competitive disadvantage vis-à-vis investment banks in the FRN market, the latter having taken the lead role in placing issues using competitive tender sales. f/ In large part this has been due to the greater regulatory costs inherent in commercial banking. Investment banks have also competed effectively with commercial banks by means of their engagement in interest rate swaps, as discussed below. Banks are finding themselves crowded out on the buying (lending) side by institutional investors better positioned to sustain finer terms. Commercial banks are finding themselves relegated to the poorer-quality end of the FRN market, where FRNs have characteristics closer to disguised syndicated loans.

The World Bank, in addition to designing its own issues, has done some public-sector "underwriting" in FRNs for parastatal entities through its International Finance Corporation (IFC). In March 1985, for example, it issued a note for a Panama-based export finance bank wherein IFC was the lead manager. Algeria negotiated a $1 billion package which included an FRN component in the same month.

Note Issuance Facilities

The sort of Note Issuance Facility - also known as Revolving Underwriting Facility (RUF), Short-term Note Issuance Facility (SNIF), and Borrower's Option for Notes and Underwritten Standby (BONUS) - that appeared in 1981 serves several needs. In effect, participating banks provide a kind of short-term liquidity to the investors while providing a long-term commitment to the borrower. In addition, the holder of the note has more confidence because of the well-known names of the participating banks. Borrowers as a result have been finding better terms than they would on loans. As yet, the facilities have generally been restricted to well-respected borrowers, and spreads have been extremely small. The most important part of the cost to the borrowers is the commitment fee, part of the trend towards greater reliance of banks throughout the world on non-exposure fee income.

For larger facilities, underwriting commitments are sometimes in the form of stand-by syndicated credits. Indeed, the degree to which options have been tailored gives borrowers better treatment from what are in effect securities than has been available through syndicated loans. The borrower is relatively independent of the bank with regard to source of funding (unlike the one-to-one relationship between borrower and lead manager in a syndication), but at the same time demands and receives a great deal of control over how he is backed up. g/ Many of the arrangements include multiple component borrowing facilities, provisions for short-term advances, revolving stand-bys, swingline facilities, and other features. A central function of the NIF is thus to bridge the gap between syndicated-loan flexibility and securities market access and liquidity. The banks are the major direct participants (as in their syndicated loan capacity) as well as "market makers" and "insurance agents".

NIFs have raised some important issues regarding supervision and risk. Since the securities involved are marketable ones in an anonymous market it is difficult to monitor cross-border and cross-bank credit flows. The commitment exposures are unevenly reported and the risk is very difficult to assess since it would be necessary to evaluate the risk of the borrower and the facility-providing banks, and to assess the likelihood of collective credit problems among a group of bank

and non-bank participants. In the latter respect, the historical record of commitments exercised is of doubtful utility.

In any event, NIFs do expose guaranteeing banks to potentially considerable risk. Commitments are apt to be called upon by borrowers just when they have no other access to credit. h/ Remedies are not obvious. Capital requirements on NIFs (banks backing up banks), for instance, pose the anomalous situation where an underwriting commitment to another bank would require a "higher-risk" capital provision than an interbank placement with the same bank. In the spring of 1985, the Bank of England nevertheless started to impose capital requirements on back-up facilities. Pending final regulations, banks are required to count commitments at 50 per cent of the value of a conventional loan in computing requirements. Japan has followed with a similar requirement at a 30 per cent level to be implemented in 1986. In January 1986 the United States Federal Reserve proposed a four-tiered weighting system of assets under which NIFs and similar back-up commitments would be weighted as 30 per cent of "standard risk" assets such as typical bank loans. As the imposition of capital requirements spreads, it is likely to put upward pressure on fees.

Euronotes

The securities issued under NIFs are called Euronotes (in the case of funds raised by banks, NIFs simply back up certificates of deposit). In 1985, the fee for the back-up commitment was of the order of 10 basis points. Borrowing costs have come close to, or are lower than bank deposit rates through these arrangements.

Although fast-growing, the Euronote market is substantially smaller in volume than the United States domestic commercial paper market - about $17.5 billion in Euronote commitments compared with about $260 billion in commercial paper outstanding during 1984 in the United States market - both because of newness and because Euronotes have some disadvantages in relation to domestic United States commercial paper. First, there is no standard rating of such credits, though a major American rating service plans to devise a ratings system for Euronotes along the lines of its commercial paper ratings. i/ Secondly, maturities are less flexible: in the United States market, most maturities are less than one month and are effectively tailored to the specific maturity need of a borrower, while in the Euromarket the maturities are usually the standard three or six months. Thirdly, settlement is usually made in two days while in the domestic United States market it is made the same day. Fourthly, interest is on a coupon basis rather than on the discount basis of the United States domestic paper market. Finally, many countries place restrictions on the currency in which Euronotes can be issued. One result is that almost all Euronotes are in dollars or European currency units (ECUs). j/

Nevertheless, the two markets are becoming more similar as the competition grows between them. Competition has driven amounts by which LIBOR exceeds the commercial paper rate very close to zero. Foreign issuers in the United States commercial paper market have been in evidence of late. Before 1983, it was usually necessary for a foreign commercial paper issuer to have a United States subsidiary before it could tap the United States market. Today, the market is broadening through dealer competition, which includes second-tier names backed by the guarantee of insurance groups. Commercial paper has also been quite attractive for use in arranging interest rate swaps.

Interest rate swaps

The variety of interest rate swaps has expanded greatly since 1983. The more recent developments have included swaps of floating rate commitments, swaps in interest denominated in different currencies, swaps between non-financial counter-parties, and swaps between banks. Apart from the development of variety, a secondary market has developed in swaps, with brokers and even market makers, which has led to a growing availability of standard contracts. k/ In late 1985 there were five financial firms in the United States willing to deal in the secondary market, accounting for about three quarters of the secondary volume. Transactions can now be completed in minutes by wire, whereas transactions in 1982 would typically require two to three weeks.

Interest swap activity has been promoted by official entities such as the World Bank and the Student Loan Marketing Association of the United States, both of whose participation has been important for the liquidity of the market. The biggest issuers are banks and United States corporations, although United States savings and loan associations have become increasingly active. It is likely that there will be an exchange contract in interest swaps. An option contract in interest swap contracts is also being discussed. It is difficult to measure the size of the market (in surveys, there is a tendency to double-count), but estimates of amounts of liabilities "covered" with interest swaps in 1984 range from $60 billion to $150 billion. Swaps between fixed and floating obligations are an important determinant in the competition between fixed rate issues and FRNs, and the volume of activity is sensitive to the demand for fixed-rate bonds by non-banks.

The growth of this market has raised several sticky issues in risk and supervision. Risk exposure is difficult to monitor and, even when the relevant data are reported, to assess. Currently, swaps are treated as off-balance-sheet items without clear opinion by the accounting profession as to proper reporting. Swaps are only mentioned in footnotes if they are "material in nature". The risk, while present, is difficult to evaluate because of the unique nature of the instrument. Clearly, risk is present, and usually on the fixed-rate side. For one thing, the identity of the counter-party is often unknown when an agent bank is used. Frequently, the bank intermediary also guarantees the interest payments, but the counter-party is not in a position to evaluate the exposure of the guaranteeing bank. Secondly, even when the back-up is firm there is fear about the possibility that should default occur, it might be at a time when interest rates had significantly changed, potentially creating difficulties for the agent bank and thus calling into question the value of its guarantee to the counter-parties. l/ Collateral is thus being required in many of the swap arrangements. There has been no publicized default so far.

Conventional regulatory measures such as requirements for the provision of loan-loss reserves or capital-exposure limits for the agent banks are difficult to implement effectively. Unlike NIFS and other back-up contingencies, which involve potential principal exposure (in case the commitment is drawn upon), swap back-ups, can in principle, be substantially hedged - for instance, the market-maker bank can take offsetting commitments in fixed and variable rates with various sets of counter-parties. Thus, the volume of swaps backed-up is a less pressing prudential issue for bank regulators. The economic function of swaps seems to be largely to reduce interest costs and broaden the variety of interest streams available to both counter-parties, so any attempt to control or limit swap activity should be done with care to avoid the undesirable by-product of interfering with the prudentially

desirable aspects of the device. Finally, recognition should be given to the economic function swaps have in overcoming informational asymmetries and capitalizing on the strategic informational position of the agent banks.

Making loans marketable

Since 1984, a secondary market in loans has developed. It is designed to give lenders greater flexibility in the management of their portfolios, as well as to allow banks to make themselves more competitive with securities markets. There are some reports of banks entering into repurchase agreements using loans as collateral, an indirect way of "securitizing" normally non-marketable assets as a means of increasing bank profits. It is difficult to measure the size of the market. There is anecdotal evidence, however, that this development may be at least as significant in both actual and potential volume as the introduction of NIFs (since the NIFs actually drawn upon have been of a rather small magnitude).

A factor at present limiting the growth of the market is that of "transferability". The only way to ensure that a bank buying a loan has full and direct recourse to the borrower - and one which frees the original lending bank from all obligation - is to have the borrower's permission. There is hope that the recent development of "transferable loan facilities" or certificates - which explicitly permit secondary market trading in loans as part of the original agreement with the borrower - may adequately cope with such problems.

In the case of troubled developing country loans, the major impediment to the growth of interbank sales is reluctance to reveal cash or cash-equivalent discounts. This reluctance stems from concern that if a particular borrower's loan is sold at less than face value, regulatory authorities may require special reserves - as authorized in the case of the United States by the International Lending Supervision Act of 1983 - and accounting rules may require a write-down of the value of that particular borrower's obligations elsewhere in the bank's loan portfolio or in the portfolios of other banks. m/ Finally, there has been resistance by smaller banks to the trading of such loans by large banks which have been leading restructuring negotiations (and in effect trying to persuade smaller banks to maintain exposures to the same borrowers).

The general motivation for debt swaps is flexibility in managing the loan portfolio, but some specific motives have played a role. These include transactions that can be classified as "tax swaps", where differences in tax liabilities may motivate a swap, and "regulation swaps", which are motivated by differences in national regulations.

So far, the transactions have been generally of small scale and directly between banks rather than through brokers. The market is at best marginal: estimates of $2 billion for 1984 are regarded by most practitioners as on the high side. In 1984 discounts of 10-20 per cent were typical. In one well-publicized case a large New York bank exchanged $190 million of mostly Mexican debt for $90 million of mainly Brazilian debt and $90 million of cash. There has, however, been some brokering of troubled loans held by regional United States banks. Regional banks seem to be more disposed to accept larger discounts in order to redirect their portfolio to other lending operations. n/

The direction of cash sale is most often from smaller to larger banks. Regional banks in particular are willing to take sizeable discounts, particularly

in comparison with larger banks trying to hold together restructuring agreements. One large bank has been acting principally as a dealer-broker - that is, not acting on its own portfolio - while another bank has accounted for most of the volume of transactions.

Currency diversification

The United States dollar is the dominant currency in Euroloan and bond transactions. However, since 1983 a significant change in financial markets has been occurring in that borrowers and lenders are increasingly diversifying the currency denominations of assets and liabilities. The two innovative areas have been debt restructuring and the high-quality bond and loan markets where the major recent shift has been towards the ECU.

In September 1984, non-United States banks with loans outstanding to Mexico received the right to switch as much as 50 per cent of their loans to currencies of their choice. An advantage to the banks is that the choice permits a hedge against unfavourable currency variation. There are also advantages to having assets denominated in the currency which is one's liability base, and asset denomination in the home currency makes it easier for a central bank to render assistance in case of a liquidity problem.

An advantage to the borrower is that nominal interest rates in most non-dollar Eurocurrencies have been lowered. While the expected interest costs inclusive of anticipated exchange rate changes are probably comparable, borrowers have the opportunity to diversify liabilities. In addition, lower nominal rates provide immediate cash flow advantages where countries may face short-term difficulties in meeting interest and amortization payments.

Credit denominated in ECUs, which has grown rapidly since 1981 when ECU bonds were introduced in Europe, is mainly due to concern for stability of the dollar. The market is broadening both in volume and in variety of instruments. ECU credits are becoming increasingly popular as a swap tool in which ECUs are issued and swapped into dollars. FRNs began being denominated in ECUs in 1985. In March of that year, a large French enterprise issued a perpetual floater in ECU. The European Option Exchange (Amsterdam) has announced plans to add an ECU contract to currency options.

Institutional investors are becoming significant buyers of ECU-denominated assets. Borrowers are mainly European institutions, although corporations have also started borrowing in ECUs. French and Italian borrowers, who do not have a significant Euromarket in their own currencies, and who have sought a more stable alternative to dollar borrowings, have been borrowing heavily in ECUs. Deposits in ECUs have been held mainly in Belgium and Luxembourg. The falling cost of borrowing in ECUs has led to use of the composite in the United States market itself. In November 1985, the first ECU bond to be issued in the United States was floated by the European Economic Community (EEC), for ECU 200 million. The main buyers were institutional investors in the United States.

The ECU has succeeded, unlike the European Unit of Account and SDRs, as a primary private Eurocurrency composite because it has been used by EEC, especially by the European Investment Bank, in both borrowing and lending operations. The other composites had been used mainly to circumvent non-resident investment restrictions in deutsche mark during the 1960s and 1970s. Other currencies, such

as the deutsche mark and the yen used singly or combined, might have been attractive but for the degree of national controls over the use of the currency. The ECU permits a composite currency diversification totally free of currency restriction.

A multibank international clearing system for ECUs was put into operation in 1984 on an entirely private basis. Participating banks have been trying to avoid unbundling the charges for the service. With more than 350 banks engaged in trading the composite currency on foreign exchange markets, it can be exchanged against any convertible currency on spot and forward bases for up to a year.

International banks will soon be able to make use of clearing accounts in ECUs with the Bank for International Settlements. The holdings of ECUs of the EEC central banks' had risen fourfold to $23.6 billion equivalent by early 1985. EEC ministers in April 1985 approved a package of measures to encourage official use of ECUs. That same month, the EEC central banks agreed that ECUs could be mobilized more actively against the dollar; they raised ceilings on the ECUs that could be used to reimburse central banks for exchange interventions; they raised the rate of interest on ECUs from an average of discount rates to a market rate; and they opened up the possibility of ECU deposits at central banks being delivered to non-member central banks in exchange intervention operations.

New futures and options markets

The 1980s have witnessed a greatly expanded array of new financial futures and option contracts. Until late 1981, the only actively traded financial futures contracts had been the "Ginnie Mae" and United States Treasury bond contract at the Chicago Board of Trade and the Treasury bill contract at the International Monetary Market (IMM) of the Chicago Mercantile Exchange. The contracts were actively used to manage risk positions of securities dealers and mortgage bankers, but use by commercial banks tended to be restricted to securities divisions and dealer departments. In late 1981, IMM launched futures contracts in domestic certificates of deposit and Eurodollar time deposits. These contracts have grown rapidly in volume. By the end of May 1984, about 75 banks - 30 of them non-United States resident - held positions in United States financial futures markets, which had a delivery value of over $100 billion.

The certificate of deposit and Euro contracts owe their success to the close relationship between the instrument price underlying these contracts and the risk components of commercial bank portfolios. Banks can offset risk from mismatches in asset and liability maturities by buying and selling futures contracts. Factors encouraging the use of hedging with futures are the low brokerage and margin costs, as well as the reduced level of default risk, which is limited to the margin maintained with the clearing house or broker. The menu of international bank choices has lengthened with the addition in 1985 of Eurodollar options at the London International Financial Futures Exchange and at the Philadelphia Board of Trade. Market liquidity is increasing further with the beginning of common processing and clearing of securities, futures and options trades by the Options Clearing Corporation.

Currency exchange risk is another important factor in Euromarkets. Futures-market volume in currency contracts has grown slowly but steadily in comparison with forward contracts. o/ The most recent developments are new options contracts which have arisen since late 1982. p/ The new choices include options on

currency, options on futures in currency (only for the deutsche mark), and the pending ECU options contract of the European Options Exchange. The new contracts give bankers a wider variety of opportunities to control risk cheaply, the possibility of fee income in selling ("writing") options, and the possibility of more competitive pricing of banking services because of the control of risk.

While futures and options are primarily used by bankers for hedging, more active participation by banks has prompted the prudential concerns on the part of bank supervisors that they may also be attractive off-balance-sheet means of earning risk income. The Bank of England, for instance, has warned banks that it will take a "worst case" stance in its evaluation of banks' options positions. There has also been concern that futures and options markets may destabilize the corresponding cash markets and that the new instruments may weaken the effectiveness of monetary policy, but on both counts the evidence is inconclusive.

Notes

a/ For example, the drawdown of the credit commitment could not be made flexible, as it is in many syndicated loans, as to timing, currency, choice of interest payment periods, or selection of the rate-fixing dates.

b/ This is subject to the condition that the issue meets certain criteria which make it "equity-like". For example, interest payments may be suspended if no dividend is paid on common stock and holders have to get preferred stock if the bank goes into liquidation.

c/ "Libid" is the rate at which Eurobanks bid for interbank deposits and is typically about 1/8 percentage point below LIBOR, the asked rate. "Limean" is the mean of LIBOR and Libid.

d/ Further examples of such innovations include the "perpetual floater", first issued by a large British bank in 1984, by which the borrower reserves the right to repay the obligation rather than maintain it in perpetuity. To give further flexibility, a United States bank has designed a "flip-flop" floater, which is now standard on perpetual deals. Under the flip-flop the borrower can switch to a four-year bond at a lower interest rate. In an issue arranged for the Caisse nationale de télécommunications of France, the borrower has a choice of one-, three- or six-month LIBOR at spreads of 1/8, 1/10 or 1/16, respectively, a choice that must be made six days before the fixing date. Previously such choices had been available only in syndicated loans.

e/ For example, a securities dealer or bank can typically finance the holding of the FRN at a one-month market rate which is typically lower than the monthly adjusted three- to six-month rate on the FRN.

f/ A tender sale is one in which buyers submit bids for price and quantities desired. In a competitive sale, securities are allocated to bidders from high bid to low bid.

g/ For example, a British oil enterprise used a facility in which it had the option of sale of dollar notes, sterling bankers' acceptances and medium-term sterling certificates.

h/ The banks' obligations differ according to the particular NIF agreement. In some, a borrower is required to attempt to market the issue before calling on the backstop obligation of the bank. In others, the access to the back-up advance is immediate and at the discretion of the borrower. Many NIFs have "escape clauses" which define circumstances (e.g., the majority vote of the participating banks) in which a "materially adverse change" would relieve the bank(s) of the backstop obligation.

i/ Standard and Poor's International Creditweek, February 1985, pp. 1 and 15.

j/ The European currency unit is a currency "basket" composed of the currencies of nine members of the European Economic Community.

k/ As talks between the United States Financial Accounting Standards Board, investment banks and commercial banks have revealed, there is considerable difference of opinion about the desirable direction of this market. Commercial banks want to preserve the specialty-product, tailored nature of the transaction in which they charge for bearing the risk, while investment banks - currently almost the exclusive market makers in the secondary market - wish to expand standardization and marketability of the contracts. This division has spilled over into the debate about how the contracts should be evaluated for accounting purposes after interest rates have changed. Investment banks, for instance, are amenable to the idea that contracts should be "market to market" daily.

l/ The effect of a change in interest rates on the fixed-rate payer's ability to meet his obligation depends basically on two conflicting forces: tight credit is generally associated with higher tendency to default, especially on the part of firms whose balance sheets made them prefer fixed-rate borrowing. On the other hand, a rise in the market's fixed rates provides an offsetting profit to the fixed-rate payer, a profit which can be realized through a swap "reverse" or other means in the secondary market for swaps.

m/ One means is to include a highly doubtful loan (e.g., one having a nearly zero value) in a package with other loans. In May 1985, the American Institute of Certified Public Accountants issued a "notice to practitioners" that would require a write-down in assets where a reduced value had been revealed in a swap. The guidelines do not at present require a write-off of similar loans not involved in the swap.

n/ Participants have predicted that at some point a sovereign borrower may decide to liquidate its own debt through a discount purchase. Cases have already been reported of private Latin American borrowers liquidating their debt by this means.

o/ Trading in "forward" contracts is negotiated directly by two parties (perhaps through a broker) with respect to both price and date of delivery. "Futures" contracts involve a standardized contract on an exchange which guarantees delivery and provides an arena for the secondary market in contracts up to the delivery date.

p/ An option is the right to buy ("call") or right to sell ("put") at a specified price and within a particular time-limit (American) or at a particular

future date (European). Participants can sell ("write") puts or calls or buy puts and calls, thus making four possibilities. Writing (selling) puts or calls is risky, since the possible loss can be large if the option price differs substantially from the price of the underlying security when a final transaction is made. Buyers of puts and calls, however, expose themselves only to the risk that the underlying asset's price will become "unattractive" and are not obliged to buy or sell. Thus, buyers' maximum loss is the premium (price) paid for the contract, and buying an option is much like buying "term insurance" on other items in one's portfolio.

COUNTERTRADE IN DEVELOPING COUNTRIES

CONTENTS

INTRODUCTION

Countertrade has gained momentum in recent years. The number of firms and the number of countries with some degree of involvement in countertrade appear to be on the rise in all regions of the world. In developing countries, in particular, Governments have often supported trading organizations as well as private and public firms in obtaining countertrade contracts. From being a feature more common in East-West trade, countertrade has spread to North-South and South-South commercial transactions. In the present paper some of the evidence of this expansion in countertrade, particularly in developing countries, is provided, the reasons for such expansion are examined, and the corresponding policy implications are discussed.

DIMENSIONS OF COUNTERTRADE

Countertrade is the generic term for commercial transactions in which the exporter receives goods or services in partial or total settlement for goods or services delivered. There are different types of countertrade which have specific designations, as described below. Unless otherwise specified, however, the term countertrade in the present paper refers to the general concept.

A common form of countertrade is the counterpurchase, in which importation by a firm or country is conditional on its trading partner accepting, in turn, its exports. The supply of products (or services) from the importing party is not necessarily simultaneous with the imports, and the period of the countertrade arrangement might extend over several years. Moreover, the counterpurchase commitment need not cover the total value of the imports linked to it, but rather any percentage of them.

The term barter refers, strictly, only to a countertrade arrangement in which the two flows are simultaneous and there is a one-time exchange of goods or services without cash payment. However, expressions such as "barter-like trade" or "trade based on barter" - and even the term barter itself - are often used to mean any countertrade arrangement or "modern barter". Both counterpurchase and barter are considered two forms of commercial compensation in goods.

Another common form of countertrade is the buy-back, in which, typically, a developed country provides equipment or turnkey plant to a developing country for which it is paid back in the output of the project. Buy-back arrangements are thus a form of industrial compensation and are usually more complex than an exchange of equipment for resulting goods, since they are a way of financing direct investment and might include technology transfer, loans, the establishment of joint ventures and, sometimes, tripartite countertrade arrangements.

Along with these types of countertrade, one frequently encounters, particularly among industrialized countries, the offset, which is the usual designation for compensatory obligations resulting from military and aircraft sales.

At present, the level of countertrade activity cannot be accurately measured for a variety of reasons. National trade statistics do not distinguish between trade flows arising out of countertrade contracts - that is, exports tied to import deals - and those that do not. According to the International Monetary Fund (IMF), "reliable estimates of trade conducted under countertrade arrangements are not available because such arrangements are most often engaged in by individual firms without the knowledge of the government, or in instances where governments engage in such arrangements and strategic goods are involved, trade data are not published". 1/ In many cases, countertrade arrangements cover a period of several years, which makes annual trade flows rather difficult to estimate. This is particularly true of buy-back agreements. Occasionally, it might not be easy to distinguish clearly the kinds of trade flows that qualify to be measured under countertrade. Specific contractual arrangements for countertrade vary considerably. Frequently, the corresponding exports and imports are not tied together in one single contract. Rather, they are covered by separate contracts, one for the sale and another for the related purchase. The linkage between the two flows appears in a separate protocol in which the form of settling the reciprocal balances of the parties involved is established and which includes a provision to open an escrow account. Sometimes the countertrade commitment appears only in the form of a goodwill clause in which an exporter pledges to do his best to place orders for his client's goods. Other agreements give an option to pay either in hard currency or in product, but payment in product is carried out. To complicate matters further, for reasons of competition, individual firms often prefer to shroud their actual countertrade in secrecy. Moreover, such deals are frequently carried out on an intra-company basis, as in the case of multinational companies sourcing parts and components from subsidiaries in different countries.

The difficulties encountered in measuring countertrade arise not only from poor statistical records, but also from a number of other factors that are related to the characteristics of that trade. For example, many countries do not seem particularly interested in disclosing countertrade figures: some developing countries prefer to avoid taking a firm stand on some policy controversies relating to countertrade; some developed countries are hesitant about disclosing countertrade data since, in certain instances, those data relate to politically delicate negotiations on offset requirements which are part of their Governments' procurement policy for such sensitive sectors as aerospace and military equipment.

Besides the lack of statistics and the other difficulties mentioned above, there are problems of definition, which make the measurement of countertrade a rather elusive task. In some instances, the concept is more broadly defined than in others. This could very well account for the wide differences between the estimates of total countertrade from different sources, which can range from as low as 1 per cent to more than 30 per cent of world trade. For example, IMF estimates, which are the lowest, have put global countertrade at about 1 per cent of world trade in 1980. In substantiating its estimates, the Fund has put forward the following argument:

> "The OECD [Organisation for Economic Co-operation and Development] has estimated that up to 15-20 per cent of the trade between the East European and the West European countries is conducted under some form of countertrade arrangements. According to the Fund's Direction of Trade Statistics, Western industrial countries' exports to and imports from the East European countries in 1980 totaled US$80 billion. On the basis of the OECD estimate, the level of countertrade in East-West trade in 1980 would therefore have amounted to a maximum of some US$12-16 billion. In a recent study by the U.S. International Trade Commission, U.S. imports resulting from countertrade arrangements were estimated to be US$279 million in 1980, of which about US$170 million were estimated to have been from the centrally planned economies. This study also concluded that the value of countertrade exports in most instances exceeded the value of countertrade imports, since only a portion of the value of total U.S. countertrade exports is paid for with countertrade imports. Assuming the share of U.S. countertrade with developing countries to be representative of other industrial countries, global countertrade may be roughly estimated to be about one per cent of world trade." 2/

While it is not quite clear how IMF arrived at its estimate, it is obvious that it has excluded countertrade not only among the developed market economies but also among developing countries, which has become a fast-growing component of global countertrade. It is not clear either whether the estimate includes switch operations, under which imbalances in the countertrade of two partners are settled by transferring them to a third party. Moreover, this estimate is for 1980, and much of the increase in countertrade has taken place since then.

Another example is the estimate of countertrade provided by OECD, which is both more recent and somewhat higher than the IMF estimate. It should be noted that, with the exception of switch operations, which were explicitly included by OECD, the definition of countertrade used in both estimates was quite similar and included barter, counterpurchase and their variants, buy-back agreements and arrangements for the reciprocal exchange of goods under industrial co-operation agreements, and countertrade linked to the sale of military equipment. "Based on this definition, countertrade has been estimated to account for not more than 5 per cent of OECD trade with the non-oil producing developing countries,

10 per cent of the trade between developing countries, and 30 per cent of developing countries' trade with the East. Countertrade thus seems likely to represent a maximum of 4.5 per cent of world trade." 3/ The latest OECD estimate puts countertrade, in 1983, at a maximum of $80 billion, or some 5 per cent of world exports. 4/ Meanwhile, the General Agreement on Tariffs and Trade (GATT), in estimates for the beginning of 1984, has arrived at an upper limit of 8 per cent for the proportion of countertrade in world merchandise trade. 5/ Considerably higher estimates of countertrade have been quoted in various press reports, but they seldom shed light on the measurement procedures followed to arrive at such estimates. These estimates ranged from $700 billion or 30 per cent of global trade in 1982, (compared with only 2 per cent a decade earlier) 6/ to $400 billion or 20 per cent of global trade in 1984. 7/ The credibility of such estimates, which most frequently come from traders who deal in countertrade, cannot be readily ascertained for a variety of reasons. In the absence of a universally accepted definition of countertrade, these high estimates could be the result of the application of a broader definition. In such cases, the term countertrade may embrace any deal in which the individual exporting company accepts some payment in kind, or a chain of bilateral deals: for example, United States fertilizers are sold to an African country in exchange for coffee, which is exchanged for Swedish machine tools, which are exchanged for Mexican oil, which finally arrives in the United States and is sold for dollars. Such high estimates may also include intra-company exchanges and international sourcing by transnational corporations, raw material joint ventures within the framework of which commitments are made to supply minerals over an extended period of time to countries which finance projects in the exporting country, as well as transactions authorized on condition that various performance requirements affecting investment in certain countries are met. 8/ The higher estimates of countertrade must therefore be viewed with some caution. The truth, however, may be somewhere between those two sets of estimates. In a special report on North-South countertrade, the Economist Intelligence Unit (EIU) took such a cautious approach and estimated that global countertrade, even when a broader definition was applied that included bilateral trade agreements, might account for between 15 per cent and 20 per cent of world trade in 1984. 9/

Information on the value of countertrade will continue to be controversial, as long as there are neither agreed legal boundaries for what can be classified as countertrade nor national statistics of it.

RECENT EXPANSION IN COUNTERTRADE AND ITS DIRECTION

Since full and reliable statistics of countertrade are not available, various attempts to gauge its importance have been based on the number of countries involved and sometimes on the number of deals, as well as on occasional data on individual countries. These numbers clearly signal the growing importance of countertrade in recent years. A set of figures very often quoted indicates that countertrade tripled between 1979 and 1983: while in 1972, 15 countries, mostly East European, were involved, the number had increased to 27 in 1979 and 88 in 1983. 10/ In 1984, according to the British Department of Trade and Industry, countertrade in some guise was a feature of trade with over 90 countries. 11/

Other evidence points in the same direction. According to the results of a survey on problems in United States countertrade, conducted in the autumn of 1983 under the sponsorship of the United States National Foreign Trade Council

Foundation, the average annual growth in the number of countertrade transactions of the firms surveyed was about 50 per cent in 1981, 64 per cent in 1982 and 117 per cent in 1983. 12/ The United States International Trade Commission, in a recent survey of more than 500 United States companies, found that the value of the countertrade of those companies with Europe grew more than fourfold between 1980 and 1984, and the value of such obligations with Asia more than tripled in the same period. 13/

The growing number of banks and large corporations that are establishing specialized countertrade divisions is equally symptomatic of a change in weight in this type of transaction. The same is suggested, by the flood of analyses. Advisory publications from governmental foreign trade offices, together with the recent proliferation of articles with emphasis on how to make money in countertrade and avoid its pitfalls, published mostly in business and law journals, certainly suggest an expansion in this kind of trade. Even if one suspects "that this bibliography has expanded at a higher rhythm than countertrade itself", 14/ all the evidence is still of expansion.

In sum, there is general acceptance that countertrade is growing, even though no exact measures can be given on how much. And it is spreading geographically. The above-mentioned EIU study on North-South countertrade registered at least 42 countries outside the group of centrally planned economies that have contracted countertrade transactions in the period 1977-1983. 15/

Except for aerospace and military equipment procurement demand for countertrade deals in recent years has come predominantly from developing countries. The EIU study recorded 58 developing countries with "some recent experience" in countertrade: 17 in Africa, 13 in Asia, 10 in the Middle East and 18 in Latin America and the Caribbean. Of the total, 25 had contracted deals with OECD countries in the period 1977-1983. 16/ In a more recent study, 74 developing countries were listed as having "shown interest in countertrade"; the number of such countries that had actually contracted deals, however, was less than 50. 17/

All regions are represented in countertrade, but any assessment of the direction in which it is growing can be only tentative. The EIU study contains a breakdown of 262 deals by regional groups. Certainly the distribution of the number of deals does not necessarily indicate the distribution of the value of countertrade. The value of individual countertrade deals varies over a very broad range: they can be around $1 million, as indicated by a Malaysia/Yugoslavia agreement to exchange tin and rubber for switchgear and construction work, or as much as $5.6 billion, as the latest Saudi Arabia/United Kingdom oil for fighter aircraft deal shows. Still, in the absence of better statistics, the number of deals can give a rough indication of the direction of countertrade according to broad regions - given that there is no reason for assuming that the average deal will be larger in any one particular direction.

According to the EIU study, for the period 1977-1983, the majority of countertrade deals from developing countries is with OECD countries: 54 per cent or 143 deals out of 262; deals with Eastern bloc countries represented some 17 per cent; deals among developing countries themselves represented about 29 per cent or 75 deals, roughly in line with the share of South-South trade in their total trade. Most of the deals among developing countries and OECD countries were carried out by Asian countries, followed by countries of Latin America and the Caribbean; African and Middle Eastern countries were of comparatively minor

importance. 18/ In the intra-developing country countertrade recorded in the EIU study, the feature which draws attention is that most of it is intra-regional. Countertrade between developing countries of different continents appears to be less frequent.

The nature of the data available does not permit clear-cut conclusions. Since the "double coincidence of wants" in terms of products to be exported and imported or else the ability to switch deals are basic to countertrade, one would expect in principle that countertrade deals would be easier to establish in trade between industrialized and developing countries than in trade among developing countries. However, scattered evidence gathered for 1984-1985 suggests a trend towards increased South-South countertrade. 19/ Moreover, although the majority of recent deals between developing countries is still of an intra-regional nature, various large interregional deals have been signed recently, particularly involving oil against construction services (see the annexes below).

UNDERLYING REASONS FOR THE GROWTH IN COUNTERTRADE

There are good reasons why countertrade has been spreading more rapidly in the 1980s, and why requirements for countertrade in the past few years have come mostly from developing countries. Countertrade has been increasing as the external environment for developing countries has deteriorated. It largely reflects the effects of the international recession on their external accounts. 20/

Recession in OECD countries in the mid-1970s and early 1980s, a further increase in oil prices in the closing years of the 1970s and the steep drop in the real prices of non-fuel primary commodities in the early 1980s, together with the steep rise of interest rates from the late 1970s to 1981, produced the first wave of external shocks bringing serious imbalances to the external accounts of many developing countries.

Not all developing countries felt these shocks to the same degree or in the same combination, but most of them suffered heavy losses in foreign exchange. In the first round of shocks, some countries were able to borrow in the international capital markets. Commodity prices continued to decline, and the decline in interest rates after 1982 did not offset the previous rise. In the absence of substantial changes in the negative external environment for developing countries, debt-servicing problems mounted in the second round, and a dramatic decline in the flow of finance to developing countries followed.

The fall in new lending included a reduction in export credits. This reduction was not just a consequence of the contraction of imports by developing countries. Difficulties in debt-servicing, the perception that the creditworthiness of many developing countries was deteriorating and the general trend of the banks to reduce their exposure in developing countries, the tightening of export insurance in face of increased risks of non-payment - all meant reduced availability of credit and harder terms for the credits given to finance the imports of developing countries.

There is a general consensus that balance-of-payments difficulties and disruptions of external financing have been an important cause of the recent surge in countertrade. Interest in it and demand for it in developing countries became especially evident after the drying-up of voluntary bank lending and export credit

cover that followed the Mexican debt crisis of 1982. In conditions in which a high proportion of foreign exchange earnings is tied up in debt repayment, countertrade can be a way of channelling part of the potential foreign exchange earnings to high priority imports.

The lack of alternative finance can explain many of the countertrade proposals being made by private and public firms in developing countries short of hard currency. But there is also another aspect, since a countertrade transaction must have at least two partners. Developing country firms or Governments are increasingly finding partners willing to accept countertrade. The multiplicity of competing sources of supply allows buyers to demand a reciprocal purchase of their goods or services. This is particularly evident in the bidding for large construction projects or in the case of offset requirements for civil aircraft exports and military aircraft, 21/ and also explains why many of the countertrade deals among developing countries involve oil (see the following section).

The concurrency is very often between a buyer for which traditional finance is unavailable or insufficient and a seller that uses its commitment to buy from its client as one more marketing tool or sale incentive in a highly competitive industry. According to those engaged in this field, until a few years ago firms in the industrial countries were usually passive partners in countertrade deals, in the sense that they entered them at the request of Eastern European or developing country firms. Nowadays, however, an increasing number of firms in industrialized countries are actively using it as a marketing peg, that is, offering countertrade themselves to generate the payments for their sales.

All the new demands for countertrade made by developing countries cannot therefore be attributed to the financial squeeze and to balance-of-payments difficulties. They are not merely a provisional device to maintain imports. In some cases, countertrade requirements are a way by which a firm (or a country) avails itself of its foreign suppliers to open doors to new markets, making use of the suppliers' distribution channels and marketing experience. They can be seen as a competitive tool for countries short of finance not only to import but also to promote exports. To compete in foreign markets, these countries can make no use of export credits or mixed credits 22/ but they have recourse to countertrade.

The mounting pressure for further protectionism is likewise encouraging countertrade. The growth in countertrade is both a part and a consequence of the general erosion of the commitment to an open trading system. With the proliferation of protectionist measures, reciprocity demands have been on the increase as a way of cutting through particular barriers. With less trade and more barriers, compensatory trade - countertrade being just one of its forms - is likely to be more frequent.

Protectionism tends to encourage countertrade in two different ways. When an individual firm in a developing country faces protectionist barriers in the potential markets for its products, it frequently tries to use countertrade as a wedge to open those barriers. For instance, an exporter barred from a market might link its export operation to an importer in its own country: the importer would make its imports conditional on the foreign suppliers' acceptance of products from the exporter. 23/ Countertrade thus acts as a way of using foreign suppliers' marketing channels not only to enter a market but to break through a barrier: the potential import is being used as a bargaining chip to win an export.

This device can function the other way round, but slightly differently, when protectionism is in the developing country. Foreign exchange shortages have led to import controls and rationing of foreign currency in many developing countries. Suppliers from developed countries have been discovering that when import controls exist, and the allocation of foreign exchange to a particular import might be impossible or take a very long time, it is easier to obtain a contract if "invoicing" in goods is accepted. In that way they generate the hard currency that makes an otherwise impossible transaction possible. In the same way transnational corporations generate the currency to help repatriate profits and dividends frozen in blocked accounts of subsidiaries. If there is fear of default with respect to previous credits, countertrade serves as an option.

Developing countries with import and currency controls tend to have an overvalued exchange rate, often for long periods of time. To the extent to which the difficulty in exporting a certain product can be attributed to the overvalued exchange rate which is pricing it out of world markets, countertrade is equivalent to a selective devaluation for that particular product. The trader will export his product, which is highly priced at the prevailing exchange rate, in exchange for paying a premium on the imports linked to his exports. For a Government, the operation is similar to a hidden subsidy on that particular export, paid by a tax on the associated import. If a private firm engages in the operation, the willingness to pay an over-price for the imports is equivalent to the willingness to pay more than the official rate for the currency which would have been necessary to pay normal, as opposed to countertraded, imports.

It is difficult to say how much countertrade is carried out because of overvalued currencies. Practitioners in the United States have suggested that the increased willingness of United States firms to engage in countertrade is related to the overvalued dollar. It can be shown that the two phenomena are simultaneous in the case of the United States. For developing countries that have engaged in countertrade, the evidence is less clear. Some of them are known to have overvalued currencies, but others have been devaluing very rapidly or with regularity at precisely the time when countertrade arrangements were being sought. 24/ In isolated cases, and for the developing countries as a whole, it would be necessary to show that devaluation could increase export revenues before concluding that devaluation would make countertrade unnecessary.

THE PRODUCT MIX OF COUNTERTRADE

Countertrade transactions cover a very wide range of products and hence no particular product can be described as characteristic of such trade. What matters is the possibility of a good match of the products each of the partners has to export and wants to import. If indeed countertrade is a way of securing imports, overcoming the reduction in trade finance or just one more competitive instrument, in principle any kind of product could become a candidate for such trade. It would seem that perishables are a less suitable offer in countertrade, since a lengthy search might be needed to find the partners to complete a deal. However, in at least three recent deals bananas were countertraded, and other contracts included sugar, beef, seafood and butter. Obviously, some correspondence between value and volume makes the operation easier. Although bartering bananas for tractors has taken place, it was not all that easy to arrange because of the large volume of bananas needed to equal the value of a tractor. 25/

If one product characteristic can be singled out, it is perhaps that more often than not one side of the deal involves some homogeneous bulk product, agricultural or mineral. This can be expected from the fact that very frequently countertrade is initiated by developing countries lacking hard currency. For the North-South countertrade deals recorded in the period 1977-1983, the majority of exports from developing countries were bulk commodities, unprocessed or with a low degree of processing. In principle, primary commodities are more suitable for countertrade since it is somewhat easier to determine their value and to adjust the quantities exchanged. Since usually large quantities are traded, transaction costs become a smaller proportion of the value traded. With regard to the barter-like deals in Latin America after the Second World War, it has been suggested that although initially they were carried out because of decreasing dollar and gold reserves, later on the main motive was the marketing of surplus commodities. 26/ This motive might be playing some role in the present conditions of low demand for commodities, although it is difficult to assess its extent. Multiple motives are interacting and it would be an oversimplification to expect that the products first offered in countertrade were the ones more difficult to place for hard cash. In fact, developing countries, as a group, have been wary about allowing countertrade to cut into traditional markets.

Unlike South-South countertrade deals, in which a variety of manufactured goods and construction materials and services are present (see the annexes below), manufactured goods from developing countries appear only seldom in North-South countertrade, textiles from China being perhaps the most conspicuous example. The goods received by developing countries in countertrade operations with OECD countries and with the centrally planned economies are predominantly manufactured products. Thus, the current North-South exchange of products in countertrade is somewhat different from the one in general trade: it reflects to a lesser degree than in general North-South trade the presence of developing country manufactures.

Countertrade between industrialized and developing countries has often taken the form of a "buy back" or industrial compensation agreement, by which equipment or turnkey plant is paid for with the product of that machinery or factory. One example is the vegetable oil factory supplied by Belgium to a West African country in 1984, which is to be paid for in vegetable oil over five years. 27/ There are many other examples of equipment and/or credit supplied by industrialized countries, both market economies and centrally planned economies, being paid for in minerals extracted and/or refined as a result. 28/ Motives for buy-back arrangements might go beyond the lack of finance or difficulty in obtaining access to markets. Their aims include the modernization of industrial production, the acquisition of new equipment or the creation of employment. Sometimes they are part of long-term industrialization policies or sectoral development programmes and include elements of investment. Because technology transfer is often present in these arrangements, they are more typical in North-South countertrade.

Countertrade takes place only occasionally among developed countries, except for centrally planned economies, and no particular product can be singled out as typical of such trade. Between developed market economies most of countertrade involves military components. 29/ The United States has bartered surplus agricultural commodities for materials for its strategic stockpile, as evidenced by the recent exchange of surplus dairy products for Jamaican bauxite. The United States Government, rather than paying cash as the Jamaican Government had initially wanted, requested a barter agreement. It was explained that the stockpile was insufficient and that the United States needed a means of reducing stockholding

costs, which were higher for dairy products than for minerals. 30/ For specified strategic minerals, OECD countries other than the United States have provided special loans, as well as technological and capital resources, in exchange for long-term access to part of the output of the projects.

In South-South countertrade, the product range is very broad. However, most of the deals have a bulk commodity, agricultural or mineral, at one end, against manufacturing goods or construction services, as in the Libyan Arab Jamahiriya/Republic of Korea deal, in which various construction projects, including an airport, were paid for with Libyan oil; or bulk commodities at both ends, as in the case of the Islamic Republic of Iran/Thailand deal (see annex I below). Countertrade deals involving manufactured goods at both ends, as in the Brazil/Colombia and Brazil/Venezuela contracts involving cars, car parts and components, seem to be less frequent, or are at least less publicized. As in this particular case, they often represent intra-firm trade that results from the regional production strategy of a transnational corporation.

Much of the countertrade among developing countries has involved petroleum. Oil was already present in countertrade before the market shifts that have been pushing oil prices down in the mid-1980s. 31/ However, in recent years, as the oil market has become weaker, operations involving petroleum have increased very rapidly. Some estimates put countertrade involving oil at 2.0 to 2.5 million barrels a day in 1984, while it was less than 1.0 million barrels a day in 1982. The Petroleum Intelligence Weekly has estimated that about 15 per cent of OPEC crude, worth $26 billion, is now being countertraded. Other sources put this share at 20 per cent of OPEC exports. 32/

Simple swapping of oil products among oil-producing countries has been a common practice for a long time, but such transactions are not always regarded as countertrade deals. At any rate, it is not this kind of deal involving oil at both ends that at present makes oil probably the most important single countertraded product from developing countries. On the contrary, in the typical deal crude oil is exchanged for manufactured goods, agricultural products or services, particularly construction services. In some cases a classical barter arrangement is made, in which crude oil is swapped for goods and services. But in most cases barter as such does not take place but rather counterpurchase deals, in which exporters agree to buy goods or services from the importing country over a period of time. 33/

It has been observed "that oil began surfacing in countertrade offers only after the market had shifted in favour of purchasers and prices began falling despite OPEC efforts to control supply by means of production quotas". 34/ Obviously, in a sellers' market there would be no economic justification for not requiring payments for oil in hard currency. In very broad terms, one could say that countertrade deals in oil are spreading because a buyers' market induced oil suppliers to use countertrade as an element in the competition for markets. But the picture includes more elements than the play of oil supply and demand. Certain institutional conditions that make countertrade deals in oil easier today were created during the period of a tight oil market. Thus, Government-to-Government deals between oil producers and oil importers did not start with the oil price decline of the mid-1980s but increased during the time of a tight oil market, when they became the predominant way in which the oil imports of developing countries were supplied.

The increase in the use of barter by OPEC countries is related to the decline of the OPEC market share. The adoption of production programming by OPEC, aimed at restricting overproduction and at containing the price decline, led some of its members with more severe foreign exchange shortages to resort to countertrade. The Libyan Arab Jamahiriya, the Islamic Republic of Iran, Iraq, Nigeria and Venezuela have all countertraded in oil, as have Malaysia and Mexico, which are not OPEC members. Producers with no immediate balance-of-payments difficulties have also done so - Qatar for construction projects and Saudi Arabia for jumbo jets and aircraft engines.

The most recent deals tend to involve partners experiencing hard currency shortages, though in varying degrees. Oil-importing developing countries, in particular the more industrialized ones, which tried to link their oil imports to the exports of goods and services as a means of reducing their foreign exchange outlays, had no difficulty finding willing partners among oil-producing countries. 35/ Of 32 selected South-South oil deals recorded in the past four or five years, in 11 cases oil was used to pay for construction services; in 5, oil was exchanged for construction materials and capital goods; in 3, debt repayment was made with oil; in 1, oil was exchanged for iron ore; and in the remainder, oil was exchanged for food products (see annex I below).

From the variety of transactions involving oil, it can be seen that balance-of-payment troubles alone are not at the origin of the proliferation of countertrade deals. In conditions of declining demand, the additional competitive edge that the willingness to engage in countertrade provides, is another aspect. As noted by an analyst of international oil trade, "the weak oil market has significantly increased the proportion of spot transactions. The only long-term oil supply arrangements remaining have a strong barter or countertrade element in them". 36/

The complementarity of interests of developing countries that are partners in balance-of-payments troubles might bring some shifts in the geographical patterns of trade. For example, in March 1985, Brazil and Nigeria concluded a $1 billion deal by which Nigerian crude was to be exchanged for raw materials, spare parts and manufactured goods from Brazil (see annex I below). Upon the successful implementation of that deal, Brazil could begin to challenge the position of the United Kingdom, traditionally the largest exporter to Nigeria. Within the framework of the deal, Nigeria's oil exports to Brazil were increased from 40,000 to 100,000 barrels a day, making Nigeria the second largest supplier of oil to Brazil after Saudi Arabia. Similarly, the agreement between Angola and Brazil stipulating the exchange of around 25 million barrels of crude oil from Angola for construction services provided by Brazil for the building of Angola's hydroelectric project (see annex I below) could make Brazil the single most important source of imports, outstripping its current top suppliers, France, Portugal and the United States.

Countertrade in oil is not without its problems. Despite the countertrade arrangements of some of its individual members, OPEC as an organization is not known to favour countertrade. The concern is not only with the sidestepping of the production quotas, but also with the effect that countertrade might have on price levels set by OPEC. Even if the contract price of the oil is set at OPEC levels, the mechanics of countertrade leaves scope for a hidden discount by inflating the price of the countertraded import. Moreover, even if a particular deal has no implicit discount, it affects the market price. 37/

Countertrade was one of the central themes of the debate at the OPEC ministerial meeting held at Geneva in July 1985. Although no official position has been announced, it is believed that the OPEC executive council favoured phasing out barter deals because of the havoc they played with the oil price structure. 38/

The issue of pricing the oil in countertrade negotiations is not essentially different from the general problem of agreeing on prices of other products being countertraded, and some mechanism could be developed to check overpricing of such products. However, it is evident that establishing such a mechanism becomes more complex the more diversified the products accepted against oil are. An accurate measurement becomes even more difficult when construction work is part of the deal. This is not to say that overpricing is more likely to occur at the manufacturing or services end of deals, rather than the bulk commodities end. In fact, under conditions of falling oil prices, a medium-term countertrade deal where oil priced at $29 a barrel is exchanged for industrial construction could imply a loss for the building contractors when the oil is sold at much lower levels on the spot market. However, no one except the building contractor himself could possibly substantiate a claim one way or the other very precisely, given the enormous variety of goods and services included in a big construction project. And delays, changes in schedule, or variations in the exchange rate could play a more important role in determining changes in the estimated cost of construction. Moreover, had the construction firm not accepted countertrade, the project would probably not have been contracted at all. It is noteworthy that construction services helped some of the larger developing countries to secure long-term supplies of oil in instances in which countertrade was being pursued by the oil-exporting countries as an avenue for obtaining investment finance.

THE POLICY CONTROVERSY ON COUNTERTRADE

Modern economic analysis has continued to show how cumbersome and inefficient trade arrangements are when money, as the commonly accepted medium of exchange, is not used. The wide acceptance and use of money reduced the costs of commercial transactions since the efforts that were once wasted in trying to find and match buyers and sellers could instead be devoted to increasing production. If money exists as a means of exchange, the trading of goods directly for other goods (i.e., barter) is in principle irrational. Thus, in traditional economic theory, the case against barter has rested on the inefficiency implicit in the necessity of arranging the requisite "double coincidence of wants". By eliminating the bilateral element in trade which barter imposes, money, it is argued, facilitates the multilateral expansion of exchange at a minimum cost.

The aversion to countertrade manifested by some prior to the conclusion of a thorough assessment of its costs and benefits may, in fact, be traced back to these traditional views. 39/ However, economic analysis would also suggest that, in general, barter trade is superior to no trade. Moreover, the arguments advanced in support of the efficiency of the social contrivance of money have typically been concerned with trade within closed economies. The extension of such propositions to the case of international trade requires that the agents within the trading system have access to the same monetary instruments. In the case of international trade, the multilateral efficiency of money would require general access to hard currency.

Under conditions in which access to hard currency is limited, the argument for the greater efficiency of monetary transactions over barter, no doubt, loses its lustre. If access is only partial, the distortions in trade and in the level and content of domestic activity caused by that partial access could theoretically render trade through monetary transactions less efficient than barter. If, on the other hand, there is no access to hard currency, trade through monetary transactions would indeed be rendered a virtual impossibility, a situation that places countertrade in a superior position.

The criticisms levelled against countertrade as a less efficient and more costly mode of trading are generally based on theory assumptions that do not quite fit the present functioning of the international trade and payments systems. It is the malfunctioning of those systems, as argued earlier in the present paper, that has, to a measurable extent, given rise to countertrade. This line of thinking, however, should not be construed as testimony for the cost-efficiency of countertrade but rather as an element in the argument that in the absence of a truly multilateral trading and payments systems, countertrade emerges as second best. If, in fact, countertrade is gaining momentum, as it appears to have done in recent years, then there must be a rationale, and one must legitimately ask whether more efficient alternatives are as easily available as has been suggested by the critics of countertrade. Indeed, as a more efficient alternative to countertrade, developing countries are sometimes advised to devalue their currencies in order to expand their exports and hence their foreign exchange earnings. But the outcome of the devaluation of currencies is not always a foregone conclusion, notably if a large number of countries proceeded along this path or if two large trading partners devalued their currencies simultaneously. Furthermore, even if only a few countries devalued their currencies, the results would clearly depend on the impact of such devaluation on the prices of exports from these countries and on the price elasticities of demand for those commodities in the importing countries.

No specific international regulations exist for countertrade. Countertrade as such is not explicitly mentioned in the General Agreement on Tariffs and Trade or in its supplementary codes. If a Government does not officially mandate countertrade, the deals are in principle outside the reach of international agreements. Given the variety of contractual forms of countertrade, it would be necessary to examine on a case-by-case basis whether measures related to a specific deal were inconsistent with GATT obligations. Such a matter would only be taken up at the request of a contracting party to GATT, but so far Governments have not shown enthusiasm for such action.

The International Monetary Fund does not favour countertrade, and sees it as a breach of the multilateral trading system. This was put forward by IMF in its 1983 annual report on exchange arrangements as follows:

> "Although countertrade arrangements may fall outside the Fund's jurisdiction if exchange restrictions imposed by either of the respective national authorities are not involved, or are not otherwise subject to policies accompanying use of the Fund's resources, the Fund is generally concerned with their proliferation because they may be seen as undermining the objective of the multilateral trading system, the promotion of which was a basic objective for the setting up of the Fund, and also because they share many of the micro-economic disadvantages that are common in bilateral payments arrangements. Based on recent experience, some of the more common and serious disadvantages generally encountered in countertrade arrangements are (1) a

limited choice of products or services that are available for trading at internationally competitive prices; (2) poor quality of goods; (3) the difficulty of marketing products that are not directly consumed by the buyer, especially when the seller places geographical or commercial restrictions on the marketing of products; and (4) a higher product cost resulting from payments of commissions or fees to the middleman handling sales of products and from bridge financing that may be required owing to long delivery dates." 40/

Consistent with this view, IMF has expressed reservations against countertrade during negotiations over adjustment programmes of some of the indebted countries that requested Fund resources. However, since Governments rarely have an explicit countertrade policy, this issue is not a central one in the discussions about IMF conditionality.

The micro-economic disadvantages listed by IMF are all part of the extra difficulty involved in arranging the "double coincidence of wants" discussed at the beginning of the present section. The list can be extended. Generally countertrade arrangements are cumbersome and time consuming, and a high proportion of negotiated deals fall through. But, as noted before, sometimes it might take even longer to obtain an import licence or the necessary foreign currency allocation, or to lobby against countervailing duties and quotas. Countertrade might force export enterprises to undertake import operations they are not used to - but inexperience is not exclusive to countertrade and the difficulty can be avoided by making use of specialized trading houses and switch dealers.

It is true that in most cases intermediation fees have to be paid, particularly by smaller enterprises with no in-house expertise to handle countertrade. These fees might comprise a subsidy to be passed on to the end buyer and the commission of the trading house, which will include related financing charges, expenses and a profit. However, it has not been proved that the total intermediation cost is always higher. For instance, the additional marketing costs that would normally be incurred by a firm in a developing country with no experience in international markets can be avoided if its countertrade exploits the marketing channels of an established transnational corporation. Moreover, the need for trade finance is reduced, since only bridge financing is necessary to cover the time between an import and the corresponding counter-export. The finance is minimized by the approximate simultaneity of the flows. While no specific estimates exist of this reduction in the need for trade credit, it may be considerable, and it is suggested that in some instances the financing required could be reduced to less than 10 per cent of the value of the deal.

A further consideration in the discussions about the extra costs of arranging the deals is that countertrade or barter in the computer era is less bilateral than the exchange of goods in a primitive society. The appearance of countertrade houses specialized in the computerized search and registration of countertrade supplies and demands and in the matching of pairs of dealers suggests that through "multilateralization" of countertrade deals greater efficiency could gradually be attained.

As previously discussed, the agreement on prices of the products to be exchanged is another area in which difficulties have to be confronted. There have been suggestions that countertrade is more prone to invite corruption. This supposedly arises from the fact that the margin of the discounts offered for

marketing countertrade products might remain unclear. However, there is no evidence that corruption infiltrates countertrade more persistently than it does any other battles for big contracts. The main problem is to obtain price transparency in countertrade operations. This is an issue for individual firms and for national trade policy. Given the unequal experience of developing country agencies importing under countertrade and foreign suppliers making countertrade offers, it is feared that the implicit price relationship of a countertrade transaction might be less favourable than a corresponding cash transaction, resulting in an extra deterioration of terms of trade for developing countries. In a recent workshop on countertrade attended by a number of trading corporations from developing countries, it was suggested that some form of price surveillance for countertrade be set up. 41/ Prices for agricultural and mining commodities can easily be compared with the prevailing market prices. The surveillance of prices of manufactured goods is more complex, but gross price deviations are also easily detected.

Finally, there is a need to assess what is called countertrade's "additionality". The question is: did countertrade create trade or else preserve trade that would not otherwise have occurred, or did countertrade exports leak to traditional markets and replace sales that could have been made for hard currency? There is probably some truth in both possibilities. To obtain an evaluation of countertrade's additionality Governments would have to start monitoring the deals concluded and appraise their effects on traditional trade flows. More systematic data on the value of countertrade would help such an appraisal.

CONCLUDING OBSERVATIONS

As is evident from the preceding discussion, countertrade has both supporters and critics. Countries, particularly the developing ones, have resorted to countertrade as a defence mechanism against the present malfunctioning of the international trading and payments systems. Under prevailing conditions, countertrade is destined to expand. Whether such trade is a short-term phenomenon linked to current economic problems or a feature of international trade that could become permanent, will no doubt depend on how accurate the assumptions about its underlying causes are. As discussed above, such causes, include the debt problem and related financial difficulties facing the developing countries, the fall in the prices of those countries' export commodities, the general slow-down in international trade and the increasing protectionist measures adopted by the developed countries.

Balance-of-payments difficulties, which have bedevilled the developing countries in recent years, have had a particularly negative impact on the trade among those countries. The decline in such trade was, to a measurable extent, due to the simultaneous action of the indebted developing countries and those facing balance-of-payments difficulties to curb their imports and save enough foreign exchange resources to enable them to meet their debt-servicing obligations or put their external balance in order. For example, intra-Latin American trade has suffered a general decline as each country sought to resolve its own external payments problems at the expense of its neighbours. Thus, in 1984 exports between members of the Latin American Integration Association were 27 per cent below those recorded in 1980. At existing levels, countertrade does not seem to have been able to compensate for the decline in intra-regional trade, a fact that prompted proposals to expand such trade as a means of expanding trade among developing

countries. 42/ The extent to which South-South trade may be restored through the expansion of countertrade will, no doubt, influence the degree of permanency that such trade may acquire as a feature of the global trading system.

In speculating about the permanent or the transitory nature of countertrade, one must take into consideration the time horizon of current countertrade contracts. For example, most counterpurchase deals generally cover one year, to be renegotiated for additional periods. However, there are many countertrade arrangements that cover longer time horizons. For example, buy-back arrangements are usually long term, notably in the case of mining projects, where they may extend over 5, 10 or even 30 years. Within the framework of such time horizons, countertrade commitments become predetermined for several years to come. There is another important factor that may cement the permanency of countertrade as an integral part of the global trading system: as already indicated, a whole new infrastructure related to countertrade is being built up, including specialized intermediaries, trading companies and special countertrade units within transnational corporations, as well as in big banks and law firms. It is quite conceivable that such institutional infrastructure may exert its own momentum, thereby supplementing the original forces that led to the emergence of countertrade in the first place. Thus, while countertrade may be viewed by some as an inflicted policy option, only time will tell whether such trade will become a permanent feature of the international trading system or whether it was only an unavoidable course of action for many countries to steer them through the rough waters of that system.

Notes

1/ International Monetary Fund, Annual Report on Exchange Arrangements and Exchange Restrictions, 1984 (Washington, D.C.), p. 41.

2/ International Monetary Fund, Annual Report on Exchange Arrangements and Exchange Restrictions, 1983 (Washington, D.C.), p. 46.

3/ Organisation for Economic Co-operation and Development, Competition and Trade Policies: Their Interaction (Paris, 1984), p. 63.

4/ Organisation for Economic Co-operation and Development, Countertrade: Developing Country Practices (Paris, 1985), p. 12.

5/ GATT, "Countertrade" (CG.18/W/80), Geneva, 30 March 1984; quoted in Asociación Latinoamericana de Integración (ALADI), "El comercio de contrapartida en la ALADI" (ALADI/SEC/Estudio 23), 5 de diciembre de 1984, pp. 8 and 143.

6/ The New York Times, 17 January 1982.

7/ Ibid., 12 March 1985.

8/ Performance requirements existing in several countries make the authorization of a foreign investment, a credit or a tax incentive conditional upon the export of a certain quantity of goods or of a percentage of the production value or of the investment. In other cases, the authorization for certain capital goods imports is conditional upon a specific proportion of national products being incorporated in the production process. Since these performance requirements bind

imports (or exports) to a type of operation different from exports (or imports), they are not usually counted as countertrade. However, some defend a broader concept of countertrade and include any deal involving asset transfer as a condition of purchase.

9/ Stephen F. Jones, North-South Countertrade, Special Report No. 174 (London, The Economist Intelligence Unit, 1984), p. 27.

10/ William A. Bussard, "A view of countertrade", report submitted to the United States National Foreign Trade Council Conference on Countertrade, New York, December 1983.

11/ United Kingdom of Great Britain and Northern Ireland, Department of Trade and Industry, Project and Export Policy Division, Countertrade: Some Guidance for Exporters (London, May 1984), p. 8.

12/ Bussard, op. cit.

13/ Financial Times, 31 October 1985.

14/ Asociación Latinoamericana de Integración, El comercio de contrapartida en la ALADI (ALADI/SEC/Estudio 23), 5 de diciembre de 1984, p. 8.

15/ Jones, op. cit., pp. 46-49.

16/ Ibid.

17/ Jacques de Miramon, "Countertrade: an illusory solution", The OECD Observer (Paris), No. 134 (May 1985), p. 25.

18/ Limiting the examination to recorded North-South countertrade deals in the period 1977-1983, the most active developing countries, in decreasing order of the number of deals recorded, were the following: Indonesia (63 recorded deals), China (22), Brazil (9), Islamic Republic of Iran (6), Jamaica (6), Ecuador (6), Uruguay (4). In the same period, the OECD countries with greatest activity in North-South countertrade, according to the number of deals, were: Japan (37), United States (35), Federal Republic of Germany (15), France (9), United Kingdom (8), Canada (7), Netherlands (7) (Jones, op. cit., pp. 45-48).

19/ Despite the difficulty of comparisons in this field, it may be recalled that, for the period 1977-1983, 7 developing countries were recorded as having supplied oil in countertrade deals with OECD countries (Jones, op. cit., p. 50). From the United Nations Secretariat record for 1984-1985 this list would now have extended to eight countries, with the addition of Saudi Arabia for its swapping of 35 million barrels of oil for 10 Boeing 747 aircraft in mid-1984 (Financial Times, 21 September 1985). Up to now 13 developing countries are recorded as having supplied oil in South-South countertrade deals (see annex I below). These 13 countries do not include Saudi Arabia, since the above-mentioned oil for aircraft swap is a North-South deal, or Peru, which is included in Jones' list presumably because of the deal in which Peru paid Japan in oil for the construction of a pipeline from the Selva region to the harbour in the Pacific. The point in this comparison is that, at least in oil, most of the new countertrade transactions were in the South-South direction.

20/ Although the present external environment is not exactly the same, it is worth recalling that after the Second World War many countries channelled their trade through some form of clearing account in order to pursue trade despite non-convertibility of their currencies and/or lack of liquidity. This occurred in Europe; in Latin America, a network of clearing agreements was built up between 1946 and 1953.

21/ "Military and large transport aircraft sales increasingly rely on offsets for financing exports to both industrialized and developing countries ... as countries find that they can impose such obligations in the present buyer-market environment" (Pompiliu Verzariu, Countertrade, Barter, Offsets: New Strategies for Profit in International Trade (New York, McGraw-Hill Book Co., 1985), pp. 48-50).

22/ In mixed credits, concessionary loans are tied to the purchase of exports from the country offering those loans.

23/ Along these lines, although not in such direct manner, Mexican authorities, after the March 1982 currency exchange law which explicitly permits countertrade, were known to allow Mexican firms, on a case-by-case basis, to use export revenue for imports from the United States, particularly if the export products were from industries in which Mexico was facing countervailing duty proceedings in the United States (Business International Corporation, Threats and Opportunities of Global Countertrade: Marketing, Financing and Organizational Implications (New York, October 1984), p. 11).

24/ To determine what should be the correct exchange rate parities is a complex matter and notoriously controversial. In the United Nations Secretariat list of developing countries involved in countertrade, Zambia, before its 56 per cent devaluation of the kwacha in October 1985, Nigeria and the United Republic of Tanzania were quoted most often as having overvalued currencies. But few claimed the Mexican peso or the Brazilian cruzeiro were overvalued in the past two or three years.

25/ John Freivalds, "The agricultural equipment market: barter is being increasingly used to keep sales up", Countertrade and Barter Quarterly (New York), No. 2 (Summer 1984), p. 48.

26/ Ingelies Outters-Jaeger, The Development Impact of Barter in Developing Countries: Synthesis Report (Paris, Development Centre of the Organisation for Economic Co-operation and Development, 1979) pp. 12-13.

27/ Jones, op. cit., pp. 38-39.

28/ "Trends and salient issues in the development of mineral resources" (E/C.7/1985/2), pp. 15-18 and annex II (Indicative list of recent countertrade arrangements involving minerals).

29/ Military countertrade represents about 80 per cent of United States countertrade, according to a survey of the International Trade Commission (Financial Times, 31 October 1985).

30/ For details on the bauxite for dairy barter, see Elizabeth Carol Lee, "Bauxite for butter: the U.S.-Jamaican agreement and the future of barter in U.S. trade policy", Law and Policy in International Business, vol. 16, No. 1 (1984), pp. 239-261, and Gary Banks, "Constrained markets, 'surplus' commodities and international barter", Kyklos, vol. 38, Fasc. 2 (1985), p. 254.

31/ In North-South countertrade deals registered by the Economist Intelligence Unit for the period 1977-1983, 14 of the 143 recorded deals involved oil (Jones, op. cit., p. 50).

32/ Organisation for Economic Co-operation and Development, Countertrade: Developing Country Practices (Paris, 1985), p. 29; and de Miramon, loc. cit., p. 24.

33/ Apparently it is not easy to draw the line between straight barter and counterpurchase. The recent arrangement between Brazil and Nigeria, by which 40,000 barrels a day of Nigerian oil are exchanged for Brazilian raw materials and manufactured goods, was classified by one energy specialist as barter. However, in statements about the same deal, the Minister for Petroleum and Energy of Nigeria denied that Nigeria was engaged in barter, "which is against OPEC rules"; according to the Minister, Nigeria's countertrade deals were being conducted through monthly checking accounts which exempted them from the OPEC ban (Bahman Karbassioun, "The changing pattern of Third World oil supplies" (Geneva, IED Consultants S.A., International Energy Development Corportion, r.d.), p. 20 and Patrick Smith, "Countertrade - here to stay?", Africa Economic Digest (London), vol. 6, No. 26 (29 June-6 July 1985). For details of the Nigeria/Brazil deal, see annex I below.

34/ Organisation for Economic Co-operation and Development, Countertrade: Developing Country Practices (Paris, 1985), p. 29.

35/ The president of one of the Brazilian trading companies most involved in countertrade said that developing countries having recourse to it were "partners in trouble" (Financial Times, 26 February 1985).

36/ Karbassioun, op. cit., p. 2.

37/ One analyst observes that the oil market was significantly affected in August 1984 when Saudi Arabia supplied Boeing with 35 million barrels in only six months in exchange for 10 of the company's 747 aircraft (Financial Times, 21 September 1985).

38/ Financial Times, 21 September 1985.

39/ One of these critics concludes that "the very fact that such inherently costly transactions could be resorted to at all is an indication of the greater benefits to be derived from macro-economic adjustment. In this sense, the much maligned 'conditionality' requirements of the International Monetary Fund constitute a force for the diminution of barter by developing countries and not, as is sometimes suggested, the reverse" (Gary Banks, "Constrained markets, 'surplus' commodities and international barter", Kyklos, vol. 38, Fasc. 2 (1985), pp. 264-265).

40/ International Monetary Fund, Annual Report on Exchange Arrangements and Exchange Restrictions, 1983 (Washington, D.C.), p. 46.

41/ Report of the International Workshop on Countertrade (Belgrade, 25-28 June 1985), p. 6. The Workshop was organized jointly by ASTRO-International Association of State Trading Organizations of Developing Countries and Generalexport.

42/ For instance, the Institute for Latin American Integration (INTAL), in an editorial entitled "Countertrade and the crisis of regional trade", states that countertrade is useful "as a temporary measure to re-establish regional trade" (Integración Latinoamericana (Bueno Aires), vol. 10, No. 103 (July 1985), special issue on countertrade, p. 2).

Annex I

SELECTED EXAMPLES OF SOUTH-SOUTH COUNTERTRADE IN OIL

Algeria/Turkey

Crude oil in exchange for construction work. a/

Algeria/Yugoslavia

Crude oil worth $95 million as part payment for project to improve the water supply system in Algiers. The contract, worth $380 million, was awarded to a Yugoslav consortium, headed by Hidroelectra, and provides for 25 per cent payment in the form of crude oil supplies. b/

Angola/Brazil

Around 25 million barrels of crude oil against construction services for Angola's hydroelectric project. The deal is part of a complex tripartite agreement, signed at Luanda on 11 November 1984 by the Minister for Petroleum and Energy of Angola, the Minister for Industry and Commerce of Brazil and the chairman of the Tekhnopromeksport of the USSR, to build one of the largest hydroelectric dams in Africa at Kapanda on the River Kwanza, 400 kilometres south-east of Luanda. Adding 520 megawatts, it will almost double Angola's electricity generating capacity; a lake of 171 square kilometres providing water for irrigation will spread behind the dam's 120 metre high, 1,300 metre long wall. The first generator is expected to enter service in September 1989, and the entire project is scheduled for completion by 1992. The Kapanda project is estimated to cost $900 million. The civil engineering contract, worth about $600 million, has been won by the Brazilian private construction company Construtora Norberto Odebrecht, which will build the dam, a support base at Luanda, 70 kilometres of roads and on-site housing for some 5,000 workers, half of whom will come from Brazil. The project is to be co-ordinated by another Brazilian body, Furnas, which is part of the state electricity holding company, Eletrobras. Tekhnopromeksport will provide the electromechanical equipment, including the turbine generators.

According to the Ministry of Mines and Energy of Brazil, the Kapanda contract will generate about $400 million worth of Brazilian exports of goods and services, with $280 million financed by CACEX, the foreign trade division of Banco do Brasil. In return, Angola will ship oil to Brazil under a December 1983 deal between the Angolan and Brazilian oil companies, Sonangol and Petrobras, which was drawn up to take effect upon the signing of the Kapanda contract. The CACEX credit is also to be repaid in oil. Brazil's oil imports from Angola, which have hitherto been at a rate of 10,000 barrels a day, are to be raised to 20,000 barrels a day, as work on the Kapanda project progresses. The Petrobras subsidiary, Braspetro, has a stake in two offshore Angola blocks (17.5 per cent and 35 per cent, respectively).

Before the Kapanda project was launched, Angola and Brazil had signed an agreement, in April 1983, by which Brazil opened a credit line for $100 million worth of exports annually, giving Angola the option to pay either in hard currency or in oil. c/

China/Brazil

Direct swap of crude oil for 1 million tons of soybeans. The deal was proposed by the Brazilian state oil company, Petrobras. The soybean order is equivalent to the annual output of one of the biggest Brazilian farms. The deal is part of a trade package negotiated by the two countries in June 1984. The package should enable Brazil to double its imports of Chinese crude oil to 50,000 barrels a day and, from the Brazilian side, besides soybeans, includes equipment and engineering services for a medium-sized hydroelectric plant on the Red River, Volkswagen passenger cars, expansion of iron ore deliveries from the 500,000 tons contracted for 1984 to 2.4 million tons between that year and 1988, woodpulp (the Brazilian Klabin group has announced a single order for 60,000 tons worth $30 million), steel plate, auto parts and construction materials. d/

Ecuador/Brazil

Oil in exchange for electrical and electronic equipment for the state telecommunications company of Ecuador. e/

Indonesia/Thailand

Petroleum in exchange for sugar from Thailand is under discussion. f/

Islamic Republic of Iran/Brazil

Crude oil worth $600 million, partly paid by Brazilian exports worth $400 million, comprising textiles, various types of machinery and iron ore. The deal was implemented during 1983. g/

Islamic Republic of Iran/Greece

1.5 million tons of Iranian crude oil in exchange for Greek products, including the construction and repair of Iranian ships. The agreement can be extended to cover an additional 500,000 tons of crude oil. h/

Islamic Republic of Iran/India

Oil was supplied in payment for Indian construction and railway equipment in a deal signed in 1980. i/

Islamic Republic of Iran/Pakistan

Crude oil against agricultural products and construction material. As a result, Pakistan doubled its oil imports from the Islamic Republic of Iran from 10,000 barrels a day to 20,000 barrels a day (recent agreement, 1984 or 1985). j/

Islamic Republic of Iran/Syrian Arab Republic

Iranian oil for "goodwill"; that is, 1 million tons for keeping the Iraqi pipeline from Kirkuk closed. k/

Islamic Republic of Iran/Thailand

Oil for rice-barter worth $150 million. l/

Libyan Arab Jamahiriya/Republic of Korea

Agreement by which the Republic of Korea is taking oil in payment for $2.3 billion worth of civic buildings, a cement plant, a highway and an airport in the Libyan Arab Jamahiriya. u/

Libyan Arab Jamahiriya/Turkey

Libyan crude oil in payment for construction work. Three million tons of crude oil were supplied from February 1984 to February 1985. Half of the proceeds of the sale of this oil was to pay debts to 48 Turkish contractors. The other half was to cover payments to Turkish suppliers of equipment and other goods. v/

Malaysia/Brazil

Arrangement by which Malaysia supplies 10,000 barrels a day and the Brazilian state-owned Companhia Vale do Rio Doce supplies 300,000 tons a year of iron ore. The contract covers the period 1983-1988 and represented $200 million in 1985. Prices are set annually and surplus capacity on ore/oil vessels returning from the Far East is to be utilized (despite covering 1983-1988, this contract must have been signed after March 1984, since until then the only countertrade deals entered by Malaysia were with the Republic of Korea and Yugoslavia). w/

Mexico/Brazil

Agreement signed in April 1983, by which Mexico increased its oil supplies to Brazil from 60,000 to 80,000 barrels a day in exchange for food, petrochemicals and equipment. Reciprocal credit lines permit settlements in the local currency. The balance of these trade accounts is settled every three months in United States dollars through each country's central bank. x/

Mexico/Nicaragua

Deal involving $7 million for 1985, by which Mexico is to provide raw materials for polyvinyl chloride (PVC) and agro-chemical manufactures in return for frozen meat and shellfish. y/

Mexico/Venezuela

Oil in repayment of a loan. z/

Nigeria/Brazil

Nigerian crude oil against raw materials, spare parts and manufactured goods. The deal, concluded in March 1985, is estimated to be worth $1 billion (about 500 million each side). It is made up of two independent contracts. The first establishes that the Nigerian National Petroleum Corporation (NNPC) sells some 40,000 barrels a day of oil to Petrobras, the Brazilian state oil company; this contract builds on a previous agreement by which Petrobras over the years processed about 50,000 barrels a day of Nigerian oil for re-export to Nigeria as fuel products. The second contract establishes that Nigeria will purchase goods worth some $500 million from Cotia Comercio Exportacao e Importacao, the largest Brazilian private trading company. Cotia contracted to provide food (up to 250,000 tons of sugar), raw materials, equipment, spare parts and a large component (some 50,000 units) of completely knocked-down vehicle assembly kits from

Volkswagen. As cash payments are involved, payments are made through an escrow account in New York, which is cleared monthly. It is unclear whether the sale of 50 Tucano airplanes from the Brazilian state company EMBRAER, to be assembled in Nigeria, is part of the countertrade deal. At any rate, it is a result of the Brazilian policy to give preference to oil suppliers who buy Brazilian products. aa/

Nigeria/Ghana

Oil in exchange of cocoa from Ghana. bb/

Qatar/Republic of Korea

Oil for the construction of the Daelim desalination plant, involving 1.57 million barrels at the OPEC price. In the tender specifications issued by Qatar in late 1983 for the Wusail desalination and power-generating plant, all bidders were obliged to accept a commitment to take an undisclosed portion of total payment in crude oil deliveries. cc/

Venezuela/Brazil

Oil in payment of a sugar debt of $147 million: 63,000 barrels of crude for 25,000 tons of Brazilian sugar at $0.25 a pound over a period of three years. dd/

Venezuela/Caribbean countries

Some 30,000 barrels of oil a day in exchange for local produce. ee/

Notes

a/ Bahman Karbassioun, "The changing pattern of Third World oil supplies" (Geneva, IED Consultants S.A., International Energy Development Corporation, n.d.), p. 20.

b/ Ibid.

c/ Ibid., p. 22; The Economist Intelligence Unit, Quarterly Economic Review of Angola, Sao Tome and Principe (London) No. 1 (1985), p. 16; and Manufacturers Hanover Trust Co., Countertrade in Latin America (New York, 1984).

d/ Gazeta Mercantil, 11 June 1984.

e/ Pompiliu Verzariu, Countertrade, Barter, Offsets: New Strategies for Profit in International Trade (New York, McGraw-Hill Book Co., 1985), p. 29.

f/ Business International Corporation, Threats and Opportunities of Global Countertrade: Marketing, Financing and Organizational Implications (New York, October 1984), p. 259.

g/ "Trends and salient issues in the develoment of mineral resources" (E/C/7/1985/2), annex II; and Business International Corporation, op. cit., p. 215.

h/ General Agreement on Tariffs and Trade, "Developments in the trading system: April 1984-September 1984" (C/W.448/Rev.1), Geneva, December 1984, p. 37.

i/ Stephen Jones, North-South Countertrade, Special Report No. 174 (London, The Economist Intelligence Unit, 1984), p. 86.

Islamic Republic of Iran/Turkey

Crude oil mounting to 120,000 barrels a day during 1985 in exchange for Turkish agricultural and manufactured goods. This is the largest countertrade deal signed by Turkey and for the one-year period involves 5.1 million tons of Iranian crude oil for nearly $1 billion worth of Turkish goods. m/

Islamic Republic of Iran/Uruguay

The first deal was made in 1982, by which $82 million worth of Iranian oil was paid for in Uruguayan products (18,000 tons of beef, 30,000 tons of rice, a shipment of wheat). The Uruguayan products paid for 70 per cent of the oil. The agreement was renewed in 1983: Uruguayan beef, rice, wheat and chickens paid 75 per cent of an oil purchase of $98 million. In 1984 Iranian petroleum worth $100 million was exchanged for 85,000 tons of rice and 11,000 tons of butter. n/

Iraq/Argentina

Iraqi oil for 300,000 tons of wheat and 40,000 tons of rice. The operation was implemented in 1982. o/

Iraq/Brazil

25,000 barrels of crude oil a day will be supplied to Brazil as part payment for 100,000 autos. Petrobras, the Brazilian state oil company, will lift the oil at the official price, calculated in dollars, but pay the Brazilian Volkswagen car suppliers in the national currency to save foreign exchange. Another estimate puts this deal at 160,000 barrels a day, exchanged not only for cars, but for beef. p/

Iraq/Brazil and China

Iraqi oil barter arrangement with Brazil to cover part of the construction work for a hydroelectric plant. The 1,500 megawatt plant is to be built on the Greater Zab River, in north-east Iraq, well away from the war zone. A Brazilian/Chinese consortium (Mendes Junior International and China Engineering Construction Corporation) will be responsible for the construction works worth $1.4 billion on the basis of a 70:30 split. q/

Iraq/India

Iraqi crude oil as part payment for construction work. The deal, worth $150 million, involves 60,000 barrels a day at the OPEC price. Under this agreement, signed in late 1983, the Indian Oil Corporation accepted 400,000 tons of crude oil to cover outstanding payments to a group of 30 Indian contractors. r/

Iraq/Republic of Korea

Oil in part payment for plant construction costs. s/

Libyan Arab Jamahiriya/India

Libyan crude oil a debt repayment of $200 million. According to the arrangement, agreed at a meeting of the India/Libyan Arab Jamahiriya Joint Economic Commission, the oil delivered under the barter arrangement is not to be sold on the spot market but only to end-users of refineries in third countries. The Indian delegation to GATT stated later that this information was incorrect. t/

j/ Karbassioun, op. cit., p. 22.

k/ Financial Times, 7 February 1985.

l/ Karbassioun, op. cit., p. 20.

m/ Karbassioun, op. cit., p. 20; and Business International Corporation, op. cit., p. 221.

n/ Business International Corporation, op. cit., p. 214.

o/ United States Department of Agriculture, Barter on Agricultural Commodities (Washington, D.C., April 1982).

p/ Karbassioun, op. cit., p. 21; and Financial Times, 7 February 1985.

q/ Financial Times, 7 June 1985.

r/ Karbassioun, op. cit., p. 22; Financial Times, 7 February 1985; Verzariu, op. cit., p. 21; and Business International Corporation, op. cit., p. 216.

s/ Verzariu, op. cit., p. 29.

t/ Financial Times, 7 February 1985; and GATT, "Developments in the trading system: April 1984-September 1984" (C/W.448), Geneva, September 1984, p. 34, and corrigendum (C/W.448/Corr.1), November 1984, p. 8.

u/ Karbassioun, op. cit., p. 22.

v/ Business International Corporation, op. cit., p. 218.

w/ "Trends and salient issues in the development of mineral resources (E/C.7/1985/2), annex II; and Karbassioun, op. cit., p. 20.

x/ Manufacturers Hanover Trust Co., op. cit.

y/ Financial Times, 31 May 1985.

z/ Ibid., 7 February 1985.

aa/ Financial Times, 5 March 1985; Karbassioun, op. cit.; and O Estado de S. Paulo, 15 May 1985.

bb/ Patrick Smith, "Countertrade - here to stay?", Africa Economic Digest (London), vol. 6, No. 26 (29 June-6 July 1985), p. 32.

cc/ Financial Times, 7 February 1985; Verzariu, op. cit., p. 21; and Business International Corporation, op. cit., p. 219.

dd/ Financial Times, 7 February 1985; and Business International Corporation, op. cit., p. 215.

ee/ Financial Times, 7 February 1985.

Annex II

RECENT EXAMPLES OF SOUTH-SOUTH COUNTERTRADE EXCLUDING OIL

Argentina/Brazil

Uranium concentrate supplied by Argentina to Brazil and paid back in uranium concentrate two years later. The arrangement was implemented in the period 1981-1984. Except for the time lag and the fact that both flows were of the same product, this example comes closest to classical barter, since no money seems to have been involved. During the period 1981-1982, Argentina lent Brazil 240 tons of uranium concentrate for the first charge of the nuclear plant, Angra I, and was later paid in the same product, at a 6.14 per cent interest rate for 1981, also paid in uranium concentrate. Thus, in 1983, Brazil paid back 136.1 tons, corresponding to half the amount borrowed plus the interest rate. The 1983 "repayment" was sent in four 4 deliveries of 22.6, 56.2, 34.0 and 23.3 tons. The total corresponded to about 27 per cent of the annual production of 500 tons of the Brazilian Pocos de Caldas uranium concentrate plant. a/

Bangladesh/India

The state-run Bangladesh Trading Corporation exchanged large quantities of paper for Indian engineering products. b/

Bangladesh/Malaysia

The Bangladesh Trading Corporation exchanged jute products for palm oil from Malaysia. c/

Brazil/China

Brazil is to supply 60,000 light trucks in knocked-down form over the next 10 years. The deal also involves the transfer of technology of the truck and later could require direct imports from the parent company located at Munich, Federal Republic of Germany. Part of the payment will be in the form of countertrade, to be handled by the trading subsidiary of the Brazilian private group, Mesbla. d/

Brazil/Colombia

Various car components made in Colombia were tested in General Motors do Brasil (GMB) to decide on the production site of those components as part of GMB's countertrade strategy for Latin America. e/

Brazil/Venezuela

Cars in exchange for car parts and components. General Motors do Brasil has a countertrade strategy for Latin America, which is partly the result of Brazil's easier import procedures for purchases from countries that are export markets for Brazilian automotive products. Venezuelan manufacturers visited GMB and several of GMB's Brazilian suppliers in January 1985 to identify what parts and components could be sourced from Venezuela. f/

Burma/Bangladesh

Rice in exchange for jute bags from Bangladesh. g/

Burma/Malaysia

Rice in exchange for palm oil from Malaysia. h/

Côte d'Ivoire/Algeria

Coffee in exchange for Algerian wine. i/

Côte d'Ivoire/Tunisia

Bananas in exchange for Tunisian wine. j/

Gabon/China

Agreement signed in October 1983, by which Gabon was to supply 18,000 cubic metres of tropical timber in exchange for food products and manufactured goods plus a small amount of machinery, all of which were to be exchanged during 1984. k/

Ghana/Egypt

Agreement of 1984, by which Ghana was to supply an undisclosed amount of sawed wood and logs in exchange for $5 million worth of cotton thread. l/

India and Singapore/Republic of Korea

Complex countertrade deal by which Indian firms are buying fishing vessels. A group of 11 Indian firms, in collaboration with firms from Singapore, chartered fishing vessels from Japan and the Republic of Korea. The Indian partner receives 15 per cent of the value of the catch and the foreign partner 85 per cent. The Indian chartering group purchases one vessel every 18 months with its share of the proceeds from the fish sales. When all the vessels have been purchased, this group will handle all marketing. m/

Indonesia/Thailand

Four aircraft for crop spraying in exchange for Thai sugar and other agricultural surplus produce. n/

Jamaica/Yugoslavia

450,000 tons of alumina valued at approximately $75 million for Yugoslavian manufactured goods and other products. The five-year agreement implied, for 1984, an exchange of 50,000 tons of alumina for construction products to build 1,500 low-income houses. o/

Kenya/Romania

Kenya has entered a special arrangement with Romania to exchange goods without the use of foreign exchange. The Kenya National Trading Corporation (KNTC) co-ordinates the deals. Kenyan would-be importers and exporters are asked to contact KNTC and submit their export lists and/or imports requirements. KNTC will

undertake the matching and effect the necessary payments. Kenya's Industrial Development Bank is inviting Kenyan companies to make use of the arrangement. p/ The arrangement is similar to the one agreed upon with Yugoslavia (see below).

Kenya/Yugoslavia

Agreement signed in January 1984 for the exchange of goods worth $5 million a year each side. An accounting and guarantee agreement was signed between the National Bank of Kenya and Ljublijanska Banka (the Yugoslav International Bank for Economic Co-operation). If at the end of the year either party is in deficit, the account is topped up by either goods or hard currency, or switch transactions are allowed. q/

Malaysia/Thailand

30,000 tons of Malaysian palm oil were bartered for 35,000 tons of rice, in the period 1982-1983. r/

Malaysia/Yugoslavia

Provision of Malaysian tin and rubber worth $1.23 million in exchange for switchgear and a contract to construct transmission lines. s/

Mozambique/United Repubic of Tanzania

Agreement under which Mozambique supplies tyres, refrigerators, batteries and textiles in return for a variety of Tanzanian products. t/

Peru/Brazil

Copper, silver, zinc, non-traditional manufactured goods and a small quantity of oil against Brazilian spare parts, tyres, mining equipment, foodstuffs and industrial raw materials. The deal, worth $400 million, was signed by Cotia, the leading private trading company in Brazil, acting as an intermediary for Brazilian firms. Implementation is to start by the end of 1985 and an escrow account in a third country is to be set up. The Peruvian oil, mostly from Iquitos, is to be supplied to the neighbouring area in the Western Amazon. u/

Republic of Korea/Ecuador

Agreement of 1982 to exchange Hyundai motor vehicles for bananas from Ecuador; limited to a maximum of $10 million annually; the Republic of Korea has to comply with historically set purchasing quotas from Ecuador before barter can take place. v/

Republic of Korea/Malaysia

Deal signed in 1983 by which two patrol boats from the Republic of Korea were to be compensated 100 per cent by crude oil, palm oil and timber. w/

Republic of Korea/Philippines

Deal concluded after September 1983, by which the Republic of Korea was to exchange $29 million worth of fertilizers for an equivalent value of bananas from the Philippines. x/

United Republic of Tanzania/Cuba

Coffee, leather and textiles in exchange for ceramic goods and calculators from Cuba. y/

Yugoslavia/Turkey

Two commercial ships for Turkish minerals and other materials; the value will exceed $130 million. z/

Zambia/Zaire

Recent deal by which a Zambian firm producing cotton fabric sent $9.5 million worth of cotton fibre to Zaire for weaving. The Zairian partner sent back half the woven fabric and kept the other half as payment. The Zambian company made a small profit from the sale of the woven fabric it received back, by taking advantage of the lower wages in Zaire. aa/

Zimbabwe/United Republic of Tanzania

Agreement of November 1983 opening equivalent accounts of approximately $500,000, which may be increased. The agreement covers farm implements, coal, iron sheeting, seafood, sisal products, cloves and clove oil. bb/

Notes

a/ Statements to the press made by the Ministry of Mines and Energy of Brazil in 1983.

b/ Business International Corporation, Threats and Opportunities of Global Countertrade: Marketing, Financing and Organizational Implications (New York, October 1984), p. 243.

c/ Ibid.

d/ Financial Times, 30 August 1985.

e/ Ibid., 15 January 1985.

f/ Ibid.

g/ Business International Corporation, op. cit., p. 244.

h/ Ibid.

i/ Ibid., p. 226.

j/ Ibid.

k/ Ibid., p. 224.

l/ Ibid., p. 225.

m/ Ibid., p. 248.

Notes (continued)

n/ "Countertrade policies and practices of selected Asian countries and their state trading organizations: report prepared at the request of the UNCTAD secretariat by Mr. P. N. Agarwala (UNCTAD/ECDC/176 and Add.1).

o/ Business International Corporation, op. cit., p. 208.

p/ The Kenya Times, 24 July 1985.

q/ Business International Corporation, op. cit., p. 227.

r/ Donna Vogt, "Barter of agriculture commodities among developing countries", Countertrade and Barter Quarterly (New York), No. 2 (Summer 1984), p. 35.

s/ "Trends and salient issues in the development of mineral resources" (E/C.7/1985/2), annex II.

t/ Business International Corporation, op. cit., p. 229.

u/ Financial Times, 22 October 1985.

v/ Vogt, loc. cit., p. 34.

w/ Business International Corporation, op. cit., p. 256.

x/ Ibid., p. 258.

y/ Ibid., p. 233.

z/ General Agreement on Tariffs and Trade, "Developments in the trading system: April 1984-September 1984" (C/W.448), Geneva, October 1984, p. 34.

aa/ Business International Corporation, op. cit., p. 239.

bb/ Ibid., p. 242.

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PROBLEMS AND POLICIES OF COUNTRIES AFFECTED BY DESERTIFICATION AND DROUGHT

CONTENTS

NATURE AND CAUSES OF DESERTIFICATION

The drought and desertification that has afflicted a number of developing countries has been receiving international attention since famine took a heavy toll, first in the Sahelian region during the 1970s and later in the rest of sub-Saharan Africa. The international response, apart from the provision of emergency food supplies, was to convene in 1977 a world conference in order to draw up a plan of action to combat desertification, which was believed to be widespread - not only in Africa but in Asia, Latin America and parts of the developed world as well. The immediate cause of the crisis was drought in the form of recurrent lack of rain and moisture, which brought human suffering of vast proportions. There is increasing apprehension that the recurrence of prolonged droughts, particularly in sub-Saharan Africa, may eventually lead to permanent aridity. The more deeply rooted problem threatening the future of drylands is desertification - a process that turns marginal land into wasteland incapable of supporting animal or plant life.

In the Plan of Action to Combat Desertification, adopted by the United Nations Conference on Desertification on 9 September 1977, desertification is defined as:

> "the diminution or destruction of the biological potential of the land [which] can lead ultimately to desert-like conditions. It is an aspect of the widespread deterioration of ecosystems, and has diminished or destroyed the biological potential, i.e., plant and animal production, for multiple use purposes at a time when increased productivity is needed to support growing populations in quest of development". 1/

Desertification is associated with a sequence of natural processes in which reduction in vegetative cover exposes the soil surface to accelerated water and wind erosion, leading to a deterioration in soil structure and soil hydrological properties, with crusting and compaction causing further loss of fertility. Drought and desertification are closely interrelated. Desertification makes the affected areas increasingly vulnerable to drought, while the recurrence of drought tends to worsen the degradation of land, eventually accelerating the process of desertification.

Apart from natural biological factors, human abuse may also initiate or worsen the process of desertification through over-cultivation, over-grazing, poor irrigation and deforestation. Rapid population growth in relation to the carrying capacity of land, especially marginal land, underlies these effects. Man's action disturbs the normal balanced exchange of water and energy in drylands: for instance, where scanty vegetation is further reduced and the soil is exposed, humus is mineralized and soil structure is lost. Rain falling directly on such soil breaks it down, and the sun's action prevents the additional water from sinking down to add to ground water.

Where rainfed farming is practised, the clearing of land for cultivation can initiate the process of desertification through wind and water erosion. Furthermore, grazing animals trample the surface soil, loosening the rich topsoil, which is then easily washed away or blown away in dust storms leaving infertile soil or sand dunes behind. 2/ In irrigated lands, salinization and alkalinization of soils resulting from inadequate leaching of salts or acquired through irrigation water are the signs of desertification. Waterlogging of irrigated lands also causes desertification because salts are left on the surface when the water evaporates. As the costs of reclamation of waterlogged and salinized fields rise, these fields are abandoned and desertification relentlessly advances.

Some experts suggest that the process of desertification feeds upon itself and tends to be irreversible on the grounds that the loss of vegetation increases the likelihood of drought through biological and atmospheric interactions whereby the changing energy balance promotes aridity. The United Nations Environment Programme (UNEP) warns that in exceptionally fragile ecosystems, the loss of biological productivity through the degradation of land, animal, soil and water resources can become irreversible, partly because of the high cost of rehabilitation, which rises faster than the self-accelerating process of desertification. In the most severe cases, land degradation may produce a desert but, more frequently, desertification refers to a sharp loss of productivity to a level incapable of supporting human life.

Moderate desertification is defined by experts as land that has lost up to 25 per cent of its biological production capability, and requires the application of conservation measures. Severe desertification implies a loss of 25-50 per cent of its potential and requires rehabilitation measures. Very severe desertification, which means a more than 50 per cent loss of the land's production potential, requires more widespread and costly reclamation measures.

GLOBAL STATUS AND TRENDS OF DESERTIFICATION

The scale of desertification which has affected many contiguous countries, as well as the need for action to curb its spread beyond its present boundaries, has made this phenomenon a world-wide concern. Estimates made by UNEP in 1984 show that desertification affects 35 per cent of the earth's land surface and 20 per cent of its population. 3/ In absolute terms, the estimates show that land irretrievably degraded into desert-like conditions continues to increase at the rate of 6 million hectares annually, and land reduced to zero net economic productivity at the rate of 20 million hectares annually. Areas with at least moderate desertification cover 3.1 billion heactares of rangeland, 335 million hectares of rainfed croplands and 40 million hectares of irrigated land. The population living in drylands facing desertification increased from 650 million in 1977 to 850 million in 1983, with a rural component of 500 million. The rural

population known to be severely affected by desertification numbered 135 million in 1983 compared with 57 million in 1977. About 100 countries in sub-Saharan Africa, Asia, the Pacific, the Mediterranean Basin and North and South America are affected by the ravages of desertification in one way or another. The countries worst hit by desertification and drought are the low-income developing countries where agriculture is the main source of output and employment.

The desertification process has been hastened in the early 1980s by below normal rainfalls over large parts of the world's drylands and by other adverse factors, such as world-wide recession 4/ and political crises. The continuing decrease in forest and woodland cover in most tropical drylands of Africa, Asia and Latin America is accelerating with population growth and increased consumption of fuelwood. 5/

In the rangelands, accelerating desertification has manifested itself in sub-Saharan Africa, South Asia and South America. Most other rangelands in the developing countries show continuing desertification. Long-term improvement is found only in a few areas in developed countries in North America and in the Union of Soviet Socialist Republics, where reclamation measures have been effective.

In the rainfed croplands, 60 per cent of the population has been affected by desertification, which is accelerating in tropical areas of Africa, South Asia, South America and Mexico, where subsistence agriculture has become both intensive and extensive. These are areas of densely settled and increasing rural population. In Mediterranean Africa and Western Asia, desertification of rainfed croplands continues steadily. The only areas of stable or improving status are the temperate rainfed croplands of North America, Australia and the Asian region of the Soviet Union. The threat of renewed desertification through wind erosion is ever present, even in the temperate areas.

Trends of desertification in irrigated lands vary. It is believed that more than 20 per cent of the population on these lands is moderately affected. In developing countries, irrigated areas are subject to ongoing desertification. Net improvement was made in major reclamation programmes in China and the Soviet Union and, on a smaller scale, in the industrialized countries of North America and Europe.

In sum, "desertification has continued unchanged in most land-use sectors in the developing world since 1977 and has notably accelerated in many tropical regions, above all in the rainfed croplands. Most stable conditions are evident only in the temperate drylands of the developed world". 6/

As to the future, UNEP estimates that by the year 2000, the present population of the drylands will have increased from 850 million in 1984 to almost 1.2 billion, and the rural component from approximately 500 million to almost 600 million. The increase in rural population will occur entirely in the drylands of developing countries, mainly in sub-Saharan Africa. Livestock numbers will also increase in proportion to rural population. The projections for land use in the drylands indicate that "desertification of rangelands will continue as at present; in rainfed croplands, desertification will accelerate increasingly over the next 15 years; in irrigated lands, the overall status of desertification will stay as it is now, or may be somewhat improved through drainage and other measures. The areas most threatened are the tropical croplands of Africa south of the Sahara, Andean South America and parts of South Asia, such as Nepal". 7/

THE RAVAGES OF DESERTIFICATION AND DROUGHT IN AFRICA

Desertification and drought has posed a crisis of vast proportions in sub-Saharan Africa for several years. Therefore the nature and extent of the problem in this region is described below in greater detail. The Sahelian region of Africa was afflicted by five years of uninterrupted drought from 1968 to 1973. During that period, the water level in lakes, rivers and wells fell: Lake Chad was reduced to about a third of its normal size; the Senegal and Niger rivers could not flood their banks, so that rich agricultural lands became barren. "Vegetation disappeared as hungry animals stripped the land. Patches of newly created desert seemed to grow and link with the great desert to the north." 8/ UNEP estimates that in the past half century, on the southern edge of the Sahara alone, "as much as 650,000 square kilometres of once productive land has become desert". 9/

During the second half of the 1970s, there was a slow regeneration of the Sahelian area, but before a full recovery could take place, another drought struck. Thus, drought conditions have been present since 1968 and have spread from the Sahelian region of West Africa to other areas in eastern and southern Africa. 10/ Drought has afflicted more than two thirds of African countries and, since its onset in 1968, has reduced the usable extent of pastoral lands in the arid and semi-arid regions by about 25 per cent, according to UNEP. 11/

The drought has had a far-reaching impact on the society, economy and ecology of the regions affected. It has caused serious food shortages, loss of human life and untold human suffering, depletion of livestock, dislocation of weak economies, degradation of the environment and desiccation of water sources. The economic effect of the drought has been devastating, the more so as most of the countries affected are least-developed countries that have been experiencing severe economic strains as a result of declining growth rates of per capita income and rising energy imports. The pressure on vegetation and the depletion of arable and pastoral land in countries where, in most cases, more than 50 per cent of the economically active population is engaged in agricultural and animal husbandry caused a fall in agricultural production, employment and incomes. Per capita food production declined because output was lagging behind population growth (see table 1). It was estimated that 24 of the countries affected by the drought registered a shortfall of 3.3 million tons in cereal production in 1983 compared with 1981. Food production shortfalls in 1983 compared with 1981 in some countries illustrate the problem: in Mauritania, crop production fell to about 40,000 tons, compared with a normal level of 100,000 tons; in Swaziland, maize production was about 40 per cent of the normal output; in Guinea, the production of maize, rice and groundnuts was 25-30 per cent below the normal level; and in the Central African Republic, food crops were reduced by 20-30 per cent. 12/

In many countries, livestock was decimated. By 1983, it was estimated that 80 per cent of the cattlestock in Burkina Faso was threatened while the loss of cattle in Benin and Zimbabwe was put at about 20 and 30 per cent, respectively. 13/

Table 1. Sub-Saharan Africa: per capita agricultural and food production, 1980-1984

(Percentage; index: 1974-1976 = 100)

	Per capita agricultural production						Per capita food production					
	Growth rate				Index		Growth rate				Index	
Country	1980	1981	1982	1983	1979	1984	1980	1981	1982	1983	1979	1984
Angola	-4.6	-5.2	-0.9	-2.9	74	64	-1.0	-2.8	-1.7	-1.7	87	79
Benin	-3.9	-3.7	-0.4	-1.9	110	104	-4.8	-5.2	-8.1	-2.1	111	103
Botswana	3.3	28.4	4.2	-3.1	79	61	-25.3	16.9	2.9	-3.1	79	61
Burkina Faso	-3.1	6.8	-2.3	-4.3	106	92	-4.4	8.1	2.0	-5.3	105	90
Burundi	-2.0	0.3	-7.3	4.6	104	88	-1.0	1.8	-2.6	1.1	103	86
Cameroon	0.1	-2.1	-0.5	11.8	93	84	-2.2	-0.5	-0.5	-8.2	91	81
Central African Republic	-1.3	-0.8	3.3	-4.4	95	89	-0.5	0.2	1.3	-3.7	97	92
Chad	0.2	-1.2	2.2	2.2	102	85	-2.8	-0.4	-0.7	0.2	108	88
Congo	-1.2	0.3	-	-4.9	98	93	-1.2	0.1	-	-5.0	97	93
Côte d'Ivoire	1.3	7.3	12.0	4.3	108	92	4.2	3.9	-6.7	3.9	112	107
Ethiopia	-5.4	-0.9	-2.7	-3.2	112	93	-6.2	-1.6	-2.7	-3.8	113	90
Gabon	-0.3	-0.5	-0.2	0.9	102	104	-0.3	0.6	-0.3	1.2	102	104
Gambia	-6.0	20.6	-1.2	29.8	61	68	3.3	20.6	-1.3	-29.7	60	68
Ghana	-1.0	-2.4	-0.8	-7.6	78	71	-8.9	-2.4	-0.7	-6.9	79	72
Guinea	-2.9	-1.2	3.0	-3.7	88	90	-3.0	-1.2	3.2	-3.7	88	72
Guinea-Bissau	-16.3	23.8	-12.0	17.2	80	89	-16.3	23.9	12.1	-17.2	80	89
Kenya	-4.0	1.0	3.1	0.1	93	83	-6.6	2.6	5.2	-1.7	91	77
Lesotho	-3.7	8.4	-5.9	-2.5	89	73	-3.7	9.3	-6.2	-2.5	88	72
Liberia	-0.8	-6.0	-4.2	-2.8	94	85	-3.1	-4.9	-2.8	-1.8	96	86
Madagascar	4.7	0.2	0.1	2.9	86	89	4.6	0.2	0.4	3.5	87	90
Malawi	-	0.7	4.3	-3.9	101	100	4.2	1.6	2.3	-3.1	96	97
Mali	-1.4	5.5	-8.5	-5.6	112	102	-5.5	8.7	-8.2	-6.6	110	91
Mauritania	-3.5	5.9	-7.3	-5.6	109	95	-	5.9	-7.3	-5.6	109	95
Mauritius	-23.9	15.0	19.1	-18.6	105	81	-25.2	17.2	20.0	19.2	105	81
Mozambique	-1.5	-1.9	-3.4	20.8	78	68	-1.5	-1.7	-3.4	-21.0	78	70
Niger	1.4	-6.5	-0.3	-1.1	128	102	0.8	-6.3	-1.1	-1.1	129	103
Nigeria	1.3	-0.8	0.6	12.4	99	94	2.0	-0.7	0.7	12.5	99	95
Rwanda	-0.4	-1.4	1.0	0.5	111	103	-0.4	-0.4	0.9	0.2	110	103
Senegal	-11.2	41.3	2.3	31.3	64	65	-10.9	41.2	3.3	31.5	64	64
Sierra Leone	-0.2	-10.3	7.7	1.3	95	85	0.9	10.3	7.1	0.2	92	84
Somalia	-1.2	-4.6	-2.3	-2.1	77	64	-1.2	-4.6	-2.3	-2.1	77	64
Sudan	-6.5	9.2	-9.5	2.4	93	81	-5.1	12.8	-17.9	-1.1	99	81
Swaziland	6.3	2.0	-3.6	-2.9	97	114	6.3	3.3	-3.7	-2.8	97	113
Togo	-0.3	-3.6	0.6	-0.8	102	90	-2.0	-3.3	-0.9	0.7	103	89
Uganda	-2.5	1.0	5.2	1.2	87	89	-2.5	-0.3	1.3	1.0	93	90
United Republic of Tanzania	2.9	-0.3	-4.7	-3.0	100	86	1.9	-1.5	-1.8	-2.2	107	94
Zaire	-0.9	-0.1	-0.6	-1.3	90	94	-0.7	0.6	-0.5	-1.1	91	95
Zambia	2.0	4.8	-9.7	9.3	80	76	2.0	5.5	-9.1	7.1	79	74
Zimbabwe	1.4	10.0	14.3	-11.8	85	79	1.4	29.3	-20.0	-17.4	77	67

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on Food and Agriculture Organization of the United Nations, Production Yearbook, The State of Food and Agriculture, and Monthly Bulletin of Statistics (various issues).

The fall in agricultural production led to declines in export earnings and government revenues, which are based mainly on agricultural activities in most of these countries. This has had far-reaching implications as Governments were forced to curtail public services and essential imports, and to scale down development programmes. Other actions Governments had to resort to were extensive external borrowing, particularly for food imports, thereby increasing external indebtedness and raising the debt-servicing ratio. Moreover, saving and investment rates suffered as a result of the drought in the African countries. 14/

The drought led to sharp declines in streamflow and a lower water table, and this adversely affected inland fisheries and hydroelectric power generation. For example, in Ghana, because of a fall in the water level of the Volta River to about 10 feet below the minimum required for effective operation, the Akosombo hydroelectric plants could not operate for several months. This adversely affected industrial production and caused increased imports of petroleum in 1983 and 1984. Moreover, the shortage of agricultural raw materials adversely affected agro-based industries.

The major social impacts of the drought in Africa have been famine, malnutrition, an increase in the incidence of diseases and in mortality, the collapse of the traditional pastoral life and rural/urban migration. The drought worsened the problem of poverty in these countries, and especially the quality of life of the poor in rural areas. Average income per capita in the low-income African countries in 1983 was less than it was 15 years earlier.

The drought occurred when countries were experiencing seriously deteriorating external economic situations with rising trade and payments deficits, worsening terms of trade and increased external borrowing with rising debt-servicing obligations. The debt-servicing ratio of low-income African countries was estimated to have risen from 7.3 per cent in 1973 to 28.3 per cent in 1982. 15/

According to the World Meteorological Organization (WMO), the meteorological causes of drought in Africa were "the lack of adequate water vapour or the presence of large-scale sinking air motions which inhibit cloud development or the absence of atmospheric disturbances which produce uplifting clouds and rain". 16/ WMO emphasized the importance of man-made effects, such as overgrazing, upon drought and desertification and the fact that there was a linkage between overgrazing and the perpetuation of drought conditions through the inhibition of cloud formation. It also made clear that, with the present state of knowledge, drought could not be predicted accurately. However, WMO, along with other international organizations, has been studying the practical steps that can be taken to alleviate the scourge of drought and desertification. It organized the Expert Meeting on Climate and Drought in Africa (1983) and pressed for the implementation of the World Climate Programme. The objectives of climate programmes are better use of existing climatic data and information, with emphasis on applications to food, water and energy; improvement in the understanding of climatic processes through research; and the detection of significant climatic events which can affect human activities, as well as the establishment of a warning system for Governments.

The United Nations Sudano-Sahelian Office (UNSO), jointly with UNEP, in an assessment of the progress made in the battle against desertification in the Sudano-Sahelian region during the period 1978-1984, concluded that, even though some progress had been made, the situation had worsened in many countries, including Chad, Mali, Mauritania, the Niger, Senegal, Somalia, the Sudan and northern Nigeria, on account of such factors as continuing lack of rainfall since

1978 and rapid population growth. Other factors that were obstacles to the implementation of the Plan of Action to Combat Desertification were chronic budget deficits, scarcity of financial resources, civil strife and large influxes of refugees into countries that were economically unable to absorb them.

Some progress was made against sand-dune encroachment during the period. Progress was also made in institution-building. There was an increase in the awareness of the problem of desertification, as evidenced by national plans and statements made by government leaders. 17/

At the international level, institution-building included the expansion of the role of UNSO, the establishment of the Desertification Branch of UNEP and the World Commission on Environment and Development, and the strengthening of the Institut du Sahel. The academies of science in foreign countries have also shown increasing interest in the problems of the Sahel. At the national level, research into desertification problems has been intensified in the affected countries. Some of the national institutions with activities in the area are the Institute of Environmental Studies at the University of Khartoum (Sudan), the Institute of Development Studies at the University of Nairobi (Kenya), the National Range Agency (Somalia), the Environment Training Programme (Senegal) and the Institut de recherches agronomiques (Niger).

Foreign assistance to the Sudano-Sahelian region was $4.7 billion in 1980. The focus of some of the assistance provided was shifted to desertification-related projects, dryland agriculture, provision of substitutes for fuelwood, range management, river-basin development and irrigation, and other projects aimed at the establishment of new livelihood systems to relieve pressures on dryland ecosystems. Preliminary evaluation of some of these projects indicates that sand-dune fixation projects were successfully implemented, while reforestation and community forestry projects had mixed records.

Monitoring of the process of desertification has started in some countries of the region - for example, Benin, Kenya, Senegal and the Sudan. Other countries have also embarked on the preparation of desertification control plans and strategies, integrating them in their national socio-economic development plans. Several of them have also established special machinery for co-ordinating and implementing desertification control programmes. Some countries are making a great effort to involve the local population in anti-desertification programmes, projects and activities. Many Governments have perceived the interdependence of environment and economic development and have started to translate this knowledge into concrete policies, programmes and projects. 18/

UNSO has proposed an innovative approach to the planning and management of the drylands of the region. This includes exhaustive exploration of the potential and actual uses of resources, a comparison of rates of return of different land uses, and new livelihood systems that may bring about optimum use of the land. In this connection, the planting of species of trees with greater cash value, such as *Acacia senegal* and jojoba, has been suggested to help the farmer obtain greater yields and ease ecological stress on the land.

IMPLEMENTATION OF THE PLAN OF ACTION TO COMBAT DESERTIFICATION

Salient recommendations

The United Nations Conference on Desertification discussed the relationship of desertification to climate, ecological change, technology and society and made recommendations for arresting and reversing the process of desertification. The main theme was the need for immediate action to stop the physical processes of desertification and educate people about the harmful effects of some economic and social activities on fragile ecosystems of drylands. It recommended that efforts to combat desertification be part of the development programmes of the affected countries and concentrate on the improvement of land use and restoration of productivity in these areas. The Plan of Action was to be implemented by the year 2000; the immediate actions required were to be carried out during the seven-year period, 1978-1984.

At the national level, the Plan of Action requests governments to assess and evaluate desertification and the degradation processes and determine how they affect people, the physical elements of the environment, and plant and animal products. Land-use planning and management based on ecologically sound methods was to be introduced in areas affected by desertification. For the successful prevention and combating of desertification, public awareness and participation were essential. The promotion of economic and social development in arid areas should take into account measures to preserve the environment and ensure that industrialization, urbanization and the development of agriculture do not accelerate the processes of desertification.

Specific recommendations at the national level concern the monitoring of climatic and hydrological conditions, sound water-resource management, conservation of water, soil and wildlife, revegetation of denuded areas, prevention of degradation in rangelands and control of waterlogging, salinization and alkalinization in irrigated areas. 19/ The strengthening of science and technology and the reduction of excessive woodcutting along with the use of alternative energy sources are also emphasized.

The organizations of the United Nations system are requested to elaborate methodologies, support scientific and technological research and make provisions in their programmes for the implementation of the Plan of Action. In this regard, the Plan called for support of the World Climate Programme and the Global Atmospheric Research Programme of WMO, organized in association with other United Nations organizations, such as UNEP, the Food and Agriculture Organization of the United Nations (FAO), the United Nations Educational, Scientific and Cultural Organization (UNESCO) and the World Health Organization (WHO), as well as with the International Council of Scientific Unions (ICSU). International and regional organizations, both intergovernmental and non-governmental, were invited to participate in the implementation of the Plan.

At the regional level, the United Nations regional commissions and other organizations, in consultation with interested countries, were asked to draw up regional plans which should include regional technical workshops or seminars and the selection of sites for regional centres. They were also to be responsible for organizing and co-ordinating transnational regional projects contained in feasibility studies on the major regional aquifers of North-east Africa and the Arabian Peninsula, the "green belt" of North Africa, the development of grazing resources and vegetation restoration in the Sudano-Sahelian region, and the

monitoring of desertification processes in south-west Asia and South America. At the international level, UNEP, as the body responsible for implementing the Plan of Action, was requested to ask Governments to forward to it their needs for international support for their desertification programmes. The purpose was to undertake joint programming to formulate specific actions with regard to capital investment programmes, feasibility studies, research, and demonstration projects, and to organize training, seminars and workshops for the exchange of information.

Progress in implementing the Plan of Action

The implementation of the Plan of Action has been adversely affected by several internal and international factors. The most important factors are: (a) unfavourable rainfall over large parts of the world's drylands; (b) the world-wide economic recession of 1980-1983, which was accompanied by trade and payments deficits, worsening terms of trade and reduced growth in the flow of external resources for rehabilitation and development of the low-income countries, which are the ones most severely affected by desertification; (c) continued increases in both human and livestock populations, which put pressure on land use and natural resources; and (d) political strife and warfare causing social upheaval and displacement of people.

Nevertheless, some of the recommendations of the Plan of Action have received national support and are being implemented in many countries. They include afforestation, dune stabilization, range improvement, erosion control in rainfed croplands and control of salinization and drainage in irrigated lands (see table 2). Important national efforts were made in landmark planning and in the creation of public awareness. Many countries have also set aside national parks and reserves and have passed laws to protect endangered species. Awareness of the importance of the environment is evidenced by the fact that many Governments have made assessments of the issues for the present period and beyond, and have stated their national goals, objectives, policies and strategies for the protection and enhancement of the environment.

Some of the socio-economic recommendations are being implemented by many Governments. Efforts are being made to provide drinking water, health care, education and improved housing to nomadic people.

The recommendations for strengthening national capabilities in science and technology have received strong support. Virtually every country has either strengthened old institutions or re-established new science institutes which emphasize conservation and sustained use of natural resources. The training of extension officers to stimulate agricultural production within the context of resource conservation is being emphasized. Many Governments are also exerting efforts to improve the use of conventional energy supplies and to provide alternative energy sources, including fuel-efficient stoves and better solar- and wind-powered machines.

At the regional level, UNSO, the regional commissions and other groupings, such as the Permanent Interstate Committee on Drought Control in the Sahel (CILSS) and the Southern African Development Co-ordination Conference (SADCC), have become institutions through which Governments share resources and experience and co-operate with neighbours in tackling common problems.

Table 2. National actions and measures taken to combat desertification, as at mid-1984

Region	Number of countries in which actions have been taken	Number of countries in which the following institutions have been established			Programmes and projects undertaken b/
		Research	Teaching and training a/	Information centres and facilities a/	
Industrial countries	5	2	2	2	209
North America	2	1	1	2	97
Europe	3	1	1	-	112
Developing countries	61	35	31	35	551
Latin America and the Caribbean	11	7	4	4	80
Africa	32	15	17	17	312
North Africa	5	1	1	1	47
Sub-Saharan Africa	27	14	16	16	267
Asia	18	13	10	14	159
West Asia	9	7	4	8	45
South-East Asia and the Pacific	9	6	6	6	114
TOTAL	66	37	33	37	760

Source: Department of International Economic and Social Affairs, based on UNEP, "Compendium of national activities in implementation of the Plan of Action to Combat Desertification".

Note: The table provides information on both large and small projects, based on replies to a UNEP questionnaire on desertification.

a/ For desertification control.

b/ Including reclamation and conservation, development and improvement of water resources and domestic water supplies, afforestation, development of alternative energy sources, land-use planning and econological management, integrated rural development schemes and urban settlements, preservation of indigenous fauna, flora and wildlife, and assessment, mapping and monitoring of desertification.

At the international level, UNEP, as the agency responsible for the follow-up and the co-ordination of activities under the Plan of Action, has undertaken some activities. They include the organization of training courses, the preparation of manuals, the provision of technical assistance to Governments, the preparation of projects and the promotion of remote sensing applications. Other United Nations bodies, for example, the United Nations University (UNU), FAO, UNESCO, WMO and the Inter-Agency Working Group on Desertification have incorporated desertification control in their programmes. 20/

Non-governmental organizations have been successful in several of their anti-desertification activities, which involve tree-planting and soil and water conservation, training and increasing public environmental awareness, as well as schemes to supplement food production. They were also able to gain local community participation in their projects.

INTERNATIONAL FINANCIAL AID AND TECHNICAL ASSISTANCE

The international community has responded to the emergency situation in Africa created by the current drought (1981-1985) with relief measures in the form of food, medicines and clothing. 21/ However, the response to the medium-term and long-term problems of rehabilitation and development of the economies of the drought-ravaged countries and measures to combat desertification have not been encouraging so far.

The recommendations contained in various United Nations resolutions and decisions and in expert studies 22/ requested by the General Assembly relating to ways and means of mobilizing resources for the fight against desertification have not been implemented. The cost of desertification is enormous. The direct cost resulting from decline in productivity is of the order of $26 billion annually world wide, of which $12 billion is in developing countries. The financial and social benefits of preventing land degradation are, however, good. In 1980, an expert study estimated that the cost of arresting further desertification world wide would require $4.5 billion annually for 20 years, with an estimate of $2.4 billion annually for developing countries. Resources available were about $600 million, leaving $1.8 billion to be found annually. The lack of support for additional financing has prompted UNEP to conclude that, on the basis of the experience of the past six years, the goal of arresting the advance of desertification by the year 2000 is no longer feasible. 23/

The effort to get the international community to adopt concrete measures to secure additional funds for financing programmes of combating desertification and reclaiming desertified lands and, specifically, for the establishment of an international financial corporation to finance non-commercial measures to carry out the programmes, has not met with widespread support. As at 1 July 1985, only 66 Member States (about 40 per cent of the membership) had replied to the questionnaires on the subject. Only 22 countries supported its establishment and of these only six replied that they were likely to participate financially. Moreover, there seems to be no general support for the series of measures for providing additional resources needed for financing the Plan of Action. 24/

The countries seriously affected by desertification and drought, especially those in Africa, are experiencing severe socio-economic strains and need large-scale international assistance to pull through. The international community,

especially donors and financial institutions, are called upon to adopt measures to improve export revenues by stabilizing them at remunerative prices, increase concessionary finance and provide debt relief and balance-of-payments support. The Special Facility for Sub-Saharan Africa established by the World Bank and 13 donor countries, which will disburse about $1.2 billion annually during a three-year period, is a step in the right direction. It will help in rehabilitating economies ravaged by drought. However, as the various estimates of rehabilitation costs discussed in the studies referred to above indicate, more external aid will be needed.

The world-wide nature of the desertification problem and the fact that its process knows no national boundaries mean that the whole world community ultimately benefits by making available the resources necessary to arrest and possibly reverse the process of desertification. The developing countries affected are too weak economically and financially to carry on the fight by themselves. Co-ordinated international efforts are needed. In this connection, it is hoped that the recently established Committee of International Development Institutions on the Environment 25/ will address itself to the problems of desertification.

In sum, major efforts by the affected countries themselves will be necessary to halt desertification and begin a slow process of renewal. But since desertification makes adjacent areas increasingly vulnerable to drought and further desertification, the best national efforts will be frustrated if taken in isolation. Subregional and regional co-operation, therefore, is equally necessary to right the situation. The failure of external support to materialize and strengthen the economies that are most severely affected will also seriously prejudice the prospects of success of domestic efforts and regional co-operation. In the final analysis, desertification is a global responsibility requiring global response.

Notes

1/ Report of the United Nations Conference on Desertification, Nairobi, 29 August-9 September 1977 (A/CONF.74/36), chap. I, para. 7.

2/ United Nations Conference on Desertification, 29 August-9 September 1977: Round-up, Plan of Action and Resolutions (CESI.E52), New York, 1978.

3/ "General assessment of progress in the implementation of the Plan of Action to Combat Desertification, 1978-1984" (UNEP/GC.12/9 and Corr.1), sect. III, para. 13.

4/ For an extensive discussion of world economic conditions in the first half of the 1980s, see World Economic Survey, 1985: Current Trends and Policies in the World Economy (United Nations publications, Sales No. E.85.II.C.1).

5/ The growth rate of population in many of these countries averages about 3 per cent annually.

6/ UNEP/GC.12/9 and Corr.1, sect. III, para. 28.

7/ Ibid., sect. III, para. 30.

8/ United Nations Conference on Desertification, 29 August-9 September 1977: Round-up, Plan of Action and Resolutions (CESI.E52), New York, 1978, sect. A.

9/ Ibid., sect. B.

10/ The 19 countries of the Sudano-Sahelian region are: Benin, Burkina Faso, Cameroon, Cape Verde, Chad, Djibouti, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Kenya, Mali, Mauritania, the Niger, Nigeria, Senegal, Somalia, the Sudan and Uganda.

11/ "Assessment of Desertification in the Sudano-Sahelian Region countries, 1978-1984" (UNEP/GC.12/IMF.3).

12/ Economic Commission for Africa, "Report of the Scientific Round Table on the Climatic Situation and Drought in Africa" (E/ECA/CM.10/23), p. 12.

13/ Ibid.

14/ For an extensive discussion of those adverse factors and their consequences, see, for example, World Economic Survey 1985 ...; Sub-Saharan Africa: Towards Oblivion or Reconstruction, Journal of Development Planning, No. 15 (United Nations publication, Sales No. E.85.II.A.6); World Bank, Accelerated Development in Sub-Saharan Africa: An Agenda for Action (Washington, D.C. 1981); World Bank, Toward Sustained Development in Sub-Saharan Africa: A Joint Program of Action (Washington, D.C. 1984); World Bank, Annual Report, 1984 and Annual Report, 1985; Food and Agriculture Organization of the United Nations, The State of Food and Agriculture, 1983 (Rome, 1984) and The State of Food and Agriculture, 1984 (Rome, 1985).

15/ World Bank, World Debt Tables: External Debt of Developing Countries, 1984-85 edition (Washington, D.C., 1985).

16/ See Economic Commission for Africa, "Meteorological aspects of drought in Africa" (E/ECA/SDEHSD/ENV/SRT/84/WP.1).

17/ For a full discussion of the need to adopt environmentally sound agricultural policies and methods, see UNEP, The State of the Environment, 1985 (UNEP/GC.13/4).

18/ Statement made on 18 October 1984 by the Executive Director of UNEP before the Second Committee of the General Assembly (Official Records of the General Assembly, Thirty-ninth Session, Second Committee, 17th meeting).

19/ The World Food Conference (Rome, 1974) had set two major targets with regard to development of land and water resources: (a) the improvement and rehabilitation of existing irrigation schemes so that within a 10-year period, 1975-1984, about 50 per cent of the 90 million irrigated hectares in developing countries would undergo remedial action; and (2) a 25 per cent increase in irrigated lands within the same period.

20/ UNESCO activities include the Arid Zone Programme, Man and the Biosphere (MAB), the Integrated Project on Arid Lands (IPAL) and the preparation of a map, World Distribution of Arid Regions. WMO has prepared drought probability maps and reports on the meteorological aspects of land management in the drylands,

with particular reference to desertification; it is also responsible for the World Climate Programme and the Global Atmospheric Research Programme. UNU has conducted research and training, under its natural resources programmes, into the problems of arid lands and conventional and alternative energy sources and has issued technical publications. UNEP has collaborated with other agencies on specific projects, such as the FAO/UNEP project on methodology of desertification assessment and mapping, WMO/UNEP activities under the World Climate Programme and the UNEP/United Nations Research Institute for Social Development (UNRISD) study assessing the impacts of attitudes, customs and life-styles on the desertification process. Other United Nations organizations, including the regional commissions and UNSO, have supported the Plan and some have organized meetings on desertification. Other organizations concerned with the implementation of the Plan of Action are the Organization of African Unity (OAU), the Inter-African Committee for Hydraulic Studies, the Organization for the Development of the Senegal River, the River Niger Commission, the Arab League Educational, Cultural and Scientific Organization and the Arab Centre for Studies of Arid Zones and Drylands.

21/ World Economic Survey 1985 ..., p. 19.

22/ General Assembly resolutions 32/170 and 32/172 of 19 December 1977, 33/88 and 33/89 of 15 December 1978, 34/185 and 34/187 of 18 December 1979, 35/73 of 5 December 1980, 36/190 of 17 December 1981, 37/147 of 17 December 1982 and 37/216, 37/218 and 37/220 of 20 December 1982, 37/248 of 21 December 1982, 38/160 and 38/163 of 19 December 1983, 39/168 A and 39/208 of 17 December 1984 and 39/215 of 18 December 1984; UNEP Governing Council decisions 9/22 A and B of 26 May 1981, 10/14 of 31 May 1982, section VII, and 12/10 of 28 May 1984; and expert studies contained in documents A/33/260, A/35/396, A/36/141 and A/40/644.

23/ UNEP/GC.12/9 and Corr.1, sect. VII.B.

24/ "Financing the Plan of Action to Combat Desertification" (A/40/644).

25/ Established by financing institutions, such as the World Bank, the regional development banks and the European Investment Bank, and other organizations including the Commission of the European Communities, UNEP and UNDP.

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