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NORTH-SOUTH NEGOTIATIONS: ISSUES AND OPPORTUNITIES

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- I. INTRODUCTION
- II. INTERRELATIONSHIP OF MARKETS
 - A. *Debts*
 - B. *Goods and Services Markets*
- III. SYSTEM AND INSTITUTIONS
 - A. *International Monetary System*
 - B. *Resources and Operating Principles*
 - C. *Control and Conditionality*
- IV. TRADE-OFFS
 - A. *Access to Markets*
 - B. *Oil*

I. INTRODUCTION

The current stalemate in North-South negotiations has lasted five years. This article suggests that the present conditions urgently call for negotiations between the developed and the developing countries. The critical financial and economic situation which faces a large number of developing countries cannot be remedied without a combination of domestic efforts and international support measures. The domestic efforts need to be aimed at raising domestic savings, better utilization of existing productive capacity, and more rational deployment of other resources than in the past. The international measures need to cover liquidity, debts, commodity prices, access to markets, foreign investment, and the international monetary and financial system. Institutional changes are needed to assure mutual support between domestic and international measures and to correct long-standing inadequacies.

Despite the large gulf which separates the developing and the developed countries at present, an agreement on a number of issues is feasible. Such an agreement could be a step forward in meeting the long-term objectives of developing countries for a more favorable position in international economic relations and help in their emergency programme of development and recovery recently proposed in New Delhi and Buenos Aires,¹ and could help to meet the objectives of the 1983 Williamsburg Summit of the leading developed market economy countries. Three factors dictate the need for "global" solutions: the close interrelationship between finance on the one hand and goods and services markets on the other; the difficulty, as indicated by the gravity of the present crisis, of carrying out new major activities without undertaking institutional changes; and the need to attain trade-offs between different countries and different groups of countries.

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¹ The Meeting of the Heads of State or Government of the Non-Aligned, held in New Delhi, March 1983; the Ministerial Meeting of the Group of 77, held in Buenos Aires, May 1983.

II. INTERRELATIONSHIP OF MARKETS

A. *Debts*

The developing countries' long and medium term debt at the end of 1982 was estimated at U.S. \$626 billion.² Short-term debt, with a maturity under one year, was estimated at U.S. \$160 billion at the end of 1982.³ Total debt was nearly U.S. \$800 billion. The service (amortization and interest) on long and medium term debt in 1982 was estimated at U.S. \$131 billion.⁴ Some estimates suggest that in 1983, total service schedule on long, medium, and short term debt may be running at a staggering figure of U.S. \$200 billion.⁵ In fact, much of the amortization is rescheduled, and some of the interest is capitalized, and as a result, both the debt outstanding and the future debt service are increasing even though the net resource transfer to the debtor countries — their receipts after the reverse flow of amortization and interest — is now negative. The deflationary effect on major debtor countries of debt service payments is enormous, and they are suffering from an acute liquidity shortage. This situation affects adversely their capacity to import and to participate in world trade and world economic activity generally.

B. *Goods and Services Markets*

It has always been recognized that the debtors cannot be expected to service successfully their debts and ultimately close the resource gap unless they have access to creditor country markets. The developing countries have been stressing this link tirelessly for years. They have now been joined by developed countries as the magnitude of the transfer problem has become more obvious and the need to combine finance and trade more pressing. As stated by the U.S. Secretary of the Treasury, on the occasion of the OECD Ministerial Meeting in early May 1983:

The key to the debt problem is this: debtor countries cannot pay off their debts unless they can earn foreign exchange through exports. And they cannot get their exporting programs on a sound footing without interim assistance. This leads to another dimension of the issue: the link between trade and finance. The trade ministers of the industrialized countries must keep their own markets open so that their banks can be repaid. The linkage, of course, goes in the other direction as well. Trade ministers cannot keep markets open unless sufficient financing is provided to cover essential imports into, and exports out of, their countries. This relationship would seem to be obvious and straightforward, so it may seem strange that so many governments have trouble coordinating their trade and finance bureaucracies and that in so many governments the two branches fail to work in concert. In so

² Organization for Economic Cooperation and Development, *External Debt of Developing Countries: General Survey 1982*, Paris, Dec. 1982.

³ Estimate by the Federal Reserve Bank of New York, as reported in the *Wall St. J.*, Nov. 5, 1982 and *Journal de Geneve*, Nov. 6, 1982. The amount of \$160 billion may well be an understatement as there was much replacement of maturing long and medium bank credit by short term credit, allegedly safer, in the closing months of 1982: a debt reorganization in reverse.

⁴ Organization for Economic Cooperation and Development, *General Survey 1982*, *supra* note 2.

⁵ Georges Corm estimates service of the twelve largest debtors at \$190 billion, or 44% of their aggregate debt principal. (Georges Corm, *Menaces sur le systeme financier international*, *Le Monde Diplomatique*, March 1983.) Seven of these twelve debtors, including four of the top five, requested postponement of payments on a part of the debt or emergency financing.

many instances, trade policy and international finance is a serious problem and one that we can ignore only at our own peril. I have become so concerned about the problem that I have proposed to give us all an opportunity to discuss the current international economic situation.⁶

The OECD Ministerial Meeting was held in Paris prior to the Williamsburg Summit. The final declaration of the latter carried a commitment to halt protectionism, to work to achieve further trade liberalization negotiations with particular emphasis on expanding trade with and among developing countries, and to secure more open markets in order to facilitate the debt burden of many developing countries.

Another key link is between finance and commodity prices. The financial crisis of 1981-82 was directly related to the collapse of commodity markets.⁷ The latter occurred as the recession became deeper and more widespread and as the upswing in interest rates forced sales from commodity inventories, the cost of carrying them having become increasingly prohibitive. The President of the World Bank has estimated that between 1980 and 1982 the annual export revenue of developing countries dropped U.S.\$40 billion, due to falling prices of non fuel commodities and stagnation of other categories of developing country exports.⁸ The oil exporting countries did not escape the calamity. The volume of oil exports fell sharply following the 1979 price increase, the recession, and the chaotic marketing conditions, leading to a large reduction in export and fiscal revenue. It is estimated that the 1982 OPEC exports amounted to U.S.\$217 billion, compared to U.S.\$302 billion in 1980, an annual fall of U.S.\$85 billion.⁹ For the surplus oil countries, a part of this loss was recouped through higher interest earnings on their foreign financial assets.

The oil situation was finally sorted out in March 1983, through the collective action of OPEC and non-OPEC oil exporters, the major actors in the latter group being Mexico, the United Kingdom and the Soviet Union. It is possible that the decision of the U.K. national oil company which competes directly with the North Sea oil, critical for solidifying the world oil market in March, was in part influenced by the apprehension that a further slide in the world oil price would lead to a further sharp depreciation of the English pound. For the oil-exporting debtor countries, the stabilization of the oil market was a matter of financial survival. Even with stabilization, some are still experiencing great difficulty. The United States Secretary of the Treasury, even though his country is the largest world importer, recently expressed apprehension regarding the possible adverse repercussions on the world financial system of a further decline in the price of oil.¹⁰ He was mentioning the major oil-exporting debtor countries which were vulnerable; one could add the apparently enormous portfolio of energy lending in domestic operations of major banks in many developed countries, of which last year's incidents involving the Continental Illinois and the Dome Petroleum may have been only the tips of the iceberg.¹¹

⁶ International Herald Tribune, May 5, 1983, *reported in* Bank for International Settlements, Press Review, May 6, 1983.

⁷ Avramovic, *Development Policies for Today*, 17 JOURNAL OF WORLD TRADE LAW 3 (1983).

⁸ Statement by A.W. Clausen at the GATT Ministerial Meeting in Geneva (Nov. 24, 1980).

⁹ AMEX BANK REVIEW, Vol. 9, No. 11 (Nov. 22, 1982).

¹⁰ Interview with Mr. Donald T. Regan, *in* International Herald Tribune, May 18, 1983.

¹¹ Dome Petroleum Ltd., a petroleum company based in Calgary, Canada, "is scrambling to sell assets and refinance a huge debt burden to avert a collapse that would rock the nation's political and banking systems . . . Dome's decline is the story of a four-year acquisition binge that back-fired because of sky-high interest rates and slumping oil markets." Wall St. J., July 22, 1982.

The Continental Illinois is based in Chicago and is the ninth largest commercial bank in the U.S.

Professor Diaz-Alejandro has summed up the relationships succinctly:

The links between international, financial and commodity markets have seldom been clearer. The absence of international bodies capable of overseeing both types of markets in a coordinated fashion has also become apparent.¹²

The third link, less publicized than those of trade and commodities, is between finance and labor migration. Recession and growing unemployment in the developed countries in recent years have led to a decline in the foreign labor force and the associated weakening of the remittance flow to the labor exporting countries. In addition, there has been a problem of reintegrating the returning workers into the domestic labor force which already operates below capacity due to the spreading recession in developing countries, superimposed on an already existing surplus labor situation. These developments have also affected, although to a lesser degree, the migrant labor working in the oil-exporting countries in the Middle East. The issue of protection of workers' rights in the labor-exporting countries has led a group of economists to suggest the establishment of a "GATT for Migration" as one way to help define a consensus on the economic rights and obligations of member states in regard to their borders and treatment of aliens.¹³

III. SYSTEM AND INSTITUTIONS

Three issues are involved here: the need to fill in the vacuum now being opened by the reluctance of the United States to continue to play the role of the lender of last resort and the linchpin of the international monetary system; the insufficiency of resources and the inadequacy of principles of operations of the major financial institutions, which renders the entire international financial system ill-equipped to cope with depressions of the magnitude of the early 1980s; and the need to introduce changes in the system of international financial and other institutions which will make them more representative of the views of their entire membership and less attached to particular theories of economic policy. Each of these issues is discussed below.

A. *International Monetary System*

There is a growing consensus among economists, businessmen, and politicians that the non-system which followed the inconvertibility of the U.S. dollar into gold since the early 1970s has outlived its usefulness. The national reserve currency standard has proven to have had an inflationary bias. Furthermore, it has conferred doubtful advantages on the reserve currency countries: they have gained in the short-run in that they have been able to pay for imports in their own currency; but they have lost over the long-run as the competitive power of their industries has fallen. Exchange rate instability

It is experiencing major difficulties because it bought poor petroleum expansion loans from the Penn Square Bank which failed two years ago, while the loans remain non-performing. The Continental Illinois suffered a major drain of liquidity recently as many depositors, apprehensive of the bank's future, withdrew their deposits. There is a question whether it will be able to survive as an independent institution.

¹² Diaz-Alejandro, *International Financial and Goods Markets in 1982-83 and Beyond* 2 (March 1983) (manuscript).

¹³ Jagdish N. Bhagwati, *Rethinking Global Negotiations*, paper submitted at a New Delhi Conference on Rethinking Global Negotiations, jointly sponsored by The Indian Council for International Economic Relations and The International Economic Research Center, Columbia Univ., New York, Jan. 1983.

in the world is increasing, and the world system now operates without a fixed point of reference.

The future of Special Drawing Rights (SDRs, "paper gold") is becoming a central issue, and it is coming to a head at the present time for several reasons. First, the U.S. financial authorities are showing an increasing unwillingness to supply dollars to the outside world to meet its liquidity and reserve needs in view of the U.S. domestic budgetary problem and the deficit in its balance of payments. Second, the authorities of other reserve currency countries, or potential reserve currency countries, such as the Federal Republic of Germany, Japan, Switzerland, the United Kingdom and Saudi Arabia, are unwilling to play individually or even collectively the role which the U.S. Treasury had played for decades; that is, being a *de facto* lender of the last resort. Third, the confidence in the private international banking system continuing to supply liquidity and reserves on a wide geographical basis has been severely shaken after the collapse of bank lending to the newly industrializing countries in August 1982. And fourth, nobody in power is prepared to take the risk of attempting to restore the gold standard. Emissions of SDRs seem the only way out, barring world deflation. Important issues are how much, to whom, and how should SDRs become an international currency rather than a hybrid of credit and money, and what relationship should the reformed SDRs have to gold.

B. Resources and Operating Principles

The experience since 1973, and particularly since August 1982, has shown that the present system of balance of payments support in a crisis is one of too little too late. The International Monetary Fund [IMF] was established to act quickly in periods of balance of payments stress in order to prevent such periods from causing devastating effects on trade, employment and welfare. The experience of the 1930s had shown that *ad hoc* deals among central banks were difficult to make in a hurry and therefore an institution with a powerful command over resources was needed. We are now back to *ad hoc* deals as the IMF resources are insufficient. The situation may be worse. Besides central banks, we now have a large number of private banks, export credit agencies, IMF and the Bank for International Settlements [BIS], each one with its own objective and pulling in its own direction. Until they all agree, crisis and deflation will continue to spread, and even after they agreed, if some pull out or never come in, the agreement will fail. Dr. Diaz-Alejandro describes it in a more general way:

The depression of the early 1980s caught the world with weakened international defenses against a maxi-recession. Quotas at the International Monetary Fund relative to world trade or to potential payments deficits had been trending down for many years....The heavy reliance of the World Bank on project lending not only limited its ability to expand operations during slump, but it has given its lending a perverse pro-cyclical character.... Concessional finance, in spite of the Pearson and Brandt commissions, has shown for many years a melancholy decline relative to GNPs [Gross National Products]....Two potentially anti-cyclical international mechanisms, the Compensatory Financing Facility of the IMF and the STABEX [Stabilization of Exports] of the European Economic Community, both charged with reducing instability in LDCs [Less Developed Countries] export earnings, proved to be woefully inadequate, both in procedure and funding, to cope with the 1981-82 collapse of LDC terms of trade.¹⁴

¹⁴ Diaz-Alejandro, *supra* note 12 at 9-10.

A gap in the Bretton Woods structure exists between the long-term project loans of the World Bank (and of the regional development banks) and the short term balance of payments lending of the IMF. The two institutions have stretched their lending practices to bridge it, through Structural Adjustment Lending of the Bank and the Extended Financing Facility of the IMF. This has helped, but is insufficient to remedy the basic defect of the structure. The World Bank Charter provides that non-project loans can be only an exception, and the IMF Charter stresses its nature as a short-term lending institution. The need for long-term programme loans and the conditions under which they can be granted remain among the central issues in development finance.

C. Control and Conditionality

The growing exposure of international financial institutions to a variety of development problems of increasing complexity and the rising number of personnel from developing countries have made a difference in the institutions' operations, attitude and image. The control has remained firmly in the major developed countries' hands, however, and this has determined the scope of operations and lending policies. Furthermore, the key institutions have retained, almost without change, their theory of economic policy; the view, or the "mind-set",¹⁵ which has been their hallmark and which conflicts with the views held by a large number of developing countries. These institutions have distinct views which influence their marshaling of funds, interpretation of facts, and policy conclusions; in fact, the Bretton Woods institutions, and particularly the IMF, condition financial assistance to policy conditions which correspond to their theory of economic policy.

Conditionality has been the single most thorny issue in North-South relations. The opportunity for conflict in the next several years will be even more frequent than in the past. Lending for balance-of-payments support will be increasing both in absolute terms and as a proportion of total and official lending because of the debt problem and the need to provide export and import financing, which is not tied to specific projects, but is linked to the needs of the economy as a whole. A new type of relationship is needed, otherwise the disputes will increase as the unfavorable situation continues, the committed amounts will not be disbursed, and the objective of avoiding major deflation and default will be defeated. The central issues of performance to which conditions are addressed are intensely political: use of public funds, tax and expenditure policies, the use of administrative controls, and price and subsidy policies. Only the developing countries can successfully resolve these internal issues. Organizational changes are needed to establish a partnership of lenders and borrowers, in which the developing countries can have greater influence on lending policies. There will be no peace in North-South relations until control commands in international financial institutions are modified and the "mind-set" approach is transformed into an open-minded approach.

IV. TRADE-OFFS

In most of the matters discussed above, it is the developing countries which have an interest in new measures. There are, however, new measures of interest to developed countries, such as access to markets, oil as a major commodity, and the international

¹⁵ Miriam Camps with the collaboration of Catherine Gwin, *Collective Management: The Reform of Global Economic Organizations* 246 (1981).

monetary system. In addition, there is foreign direct investment, which is of interest to both groups of countries.

A. Access to Markets

The developed countries have insisted on trade liberalization in the more advanced developing countries in view of the rapid rise in the latter's markets in recent years. This rise was due partly to income growth and partly to trade liberalization measures already taken. A recent study indicates that the proportion of "managed" trade in non-oil developing countries' total trade fell from about 50% to 45% between 1974 and 1980.¹⁶ In contrast, this proportion increased in OECD countries, from under 40% to almost 50%.¹⁷ The on-going deterioration in the developing countries' financial situations has adversely affected their imports and import policies and will continue to do so. This situation, however, will not be permanent, and there are developing countries whose external finances are currently in good shape. Trade liberalization is important for them not only because it helps provide external markets, but when combined with growing employment, it leads to better resource allocation. The condition for liberalization should be that there be full reciprocity in the developed countries, and that liberalization in developing countries be subject to the balance of payments constraints and infant industry considerations. With these safeguards, there is much to gain from trade liberalization for all countries concerned.

B. Oil

It has been argued recently that "the oil card" has been played out, and therefore, in the present period of plentiful energy, the North does not have sufficient incentives to enter into global negotiations which were initially based on the apprehension of an energy shortage.¹⁸ This is probably a short view which is not shared by the International Energy Agency. A recent analysis has stressed the link between economic growth in the market economies and the growth in OPEC supplies of oil,¹⁹ and it is likely that the planners in the industrialized countries are aware of these relationships.

The need for, and the possibility of concluding a commodity arrangement for oil should be considered in view of the widely fluctuating export revenues in recent years and the disastrous effects on many oil-producing countries, the importance of assuring a predictable movement of prices and supplies of this vital and fundamentally scarce product, and the continuing interdependence of the issue of oil and energy with all issues in North-South relations. Recent reports suggest a favorable attitude to renewed contacts between consumers and producers of oil.²⁰

C. Foreign Direct Investment

It is well known that the leading developed countries attach great importance to the expansion of direct foreign investment. In turn, a number of developing countries are

¹⁶ Sheila Page, *The management of international trade*, discussion paper No. 29, National Institute of Economic and Social Research, London, 1982, noted in *THE ECONOMIST*, Dec. 25, 1982.

¹⁷ *Id.*

¹⁸ Bhagwati, *supra* note 13.

¹⁹ Iain Begg, Francis Cripps and Terry Ward, *Why oil prices must remain high*, *CAMBRIDGE ECONOMIC POLICY REVIEW*, Jan. 1983.

²⁰ *International Herald Tribune*, June 9, 1983; *Journal de Geneve*, June 10, 1983; *Le Monde*, June 14, 1983.

now adopting measures to attract such investment, both from the traditional sources in the North and the new suppliers of capital in the South. Its financial attractiveness has increased in view of the high cost of loan capital and the rigid burden it imposes in the face of weak and fluctuating exports.

There are currently two major proposals for promoting direct investment within a multilateral framework. First, the Brandt Commission has proposed the establishment of an international procedure for discussions and consultations on measures affecting direct investment.²¹ This could lead to the adoption of an international legal regime for such investment, which would bring together all the various international codes of conduct which have either been agreed upon, or are currently under negotiation. Second, the President of the World Bank has proposed the establishment of a multilateral investment insurance agency covering foreign investment.²² By covering certain classes of risks, such as nationalization, and war and transfer difficulties, the agency would stimulate direct investment. Participation in any of these two arrangements would be voluntary, and management would presumably be shared between developed and developing countries.

V. CONCLUSION

Sufficient common ground exists to warrant a new attempt at an across-the-board arrangement between the North and the South. Such an arrangement could not solve everything at the present time, but it could contribute to the solution of the most urgent issues and start the preparatory process for structural reforms. The arrangement could be negotiated between the Organization for Economic Cooperation and Development [OECD] on behalf of the North, and the Group of 77 on behalf of the South. It may consist of the following:

- (a) An urgent and substantial injection of liquidity for developing countries. This would arrest further deflation in their economies and help enable the existing financial obligations to be met while negotiations on debt reorganization are under way. A special issue of SDRs for the benefit of developing countries is suggested for this purpose;
- (b) Debt reorganization aimed at long-term funding of part of the short-term debt of developing countries and the renegotiation of interest rates as appropriate;
- (c) The stabilization of commodity prices on a broad basis, including oil;
- (d) A moratorium on new restrictions on market access for exports from developing countries and adoption of a mutual trade liberalization programme, subject to the foreign exchange and infant industry constraints;
- (e) Arrangements for the promotion of direct foreign investment; and
- (f) An agreement to proceed with preparations for an international monetary and financial conference.

At the present time, there is a unique opportunity to proceed along the above or similar lines. The developing countries have shown flexibility in their approach, particularly since the New Delhi and Buenos Aires meetings, while the developed countries have become more aware of the inherent dangers in the present unstable financial and trade situation.

²¹ *North-South: A Programme for Survival*, The Report of the Independent Commission on International Development Issues under the Chairmanship of Willy Brandt, London, 1980, Ch. 12.

²² Address by A.W. Clausen to the Board of Governors, WORLD BANK (Sept. 29, 1981).