69522

MEETING OF AFRICAN POLICY-MAKERS AND EXPERTS ON THE WORK OF THE SOUTH COMMISSION

HOSTED BY THE UNITED NATIONS ECONOMIC COMMISSION FOR AFRICA (ECA)

Addis Ababa

January 22-23, 1990

ISSUES PAPER # 3

"North-South Relations and the Management of the International System"

December 1989

NORTH SOUTH RELATIONS AND THE MANAGEMENT OF THE INTERNATIONAL SYSTEM

I. INTRODUCTION

1. The debt crisis and related developments in the last decade have amply confirmed that the present relationships between the South and the North are fundamentally inimical to the development of the South. They deny the South the resources it needs for development and deprive it of any significant say in decisions about the operation of the world economy. This situation is an expression of the enormous and self-perpetuating difference in economic power between North and South, in turn a reflection of the international division of labour which has condemned the South to specialize in low-value-added, low technology production and exports.

2. The South Commission strongly believes that there cannot be sustained development in the South without a fundamental restructuring of the international system to eliminate this form of domination and exploitation. It also believes that, in the process, a better, more rational and more lasting world economic system can be built. International economic reform, while being a demand of the South, is equally a need of the international system and therefore a challenge to the international community as a whole. The reform must include a restructuring of the international financial, monetary and trading systems; the introduction of fair international regimes for science and technology and for the management of the environment and the

global commons; and the restructuring of international institutions to make them more democratic, more effective, more supportive of development and in the end more capable of achieving an orderly and equitable management of global interdependence

3. In this issues paper the major proposals that the South Commission is considering with a view of bringing about a more equitable management of world economic affairs are presented. Participants are requested to review them with the aim of contributing to their further development.

II. PROPOSALS FOR AN ORDERLY AND EQUITABLE MANAGEMENT OF GLOBAL INTERDEPENDENCE

Finance for Development

4. The Debt Crisis. A reform of the international financial system is critical for achieving the goal of an orderly and equitable management of world economic affairs. The reformed, rational international financial system that the Commission envisions is one in which capital flows from the rich to the poor countries in line with the long-accepted principle of international economic cooperation. At present the situation is the reverse: an absurd and intolerable position in which massive resources are flowing from the South to the North.

5. To redress this unacceptable state of affairs, an equitable solution to the debt problem is an urgent priority. There must be multilateral action directed towards scaling down the debt and reducing the debt service burden. The point must now be accepted once and for all by the international community as a whole that the nominal external debt of the developing countries is not repayable in full, and that its nominal value will not be paid in full.

6. The Brady initiative is a cautious recognition of this. However, from what is known, the plan is clearly inadequate. What is needed instead is a concerted approach to achieve debt reduction and debt service reduction simultaneously. The Commission believes that negative resource transfers should be ended and the service of the debt related to the ability of the economy to pay and to grow. The amount of debt service a country is required to pay should be determined by the level of resources it needs to revive growth of per capita income and sustain it at a level of at least 2-3 per cent per annum.

7. Any global solution to the problem of debt must include specific provisions to deal with the case of the countries of Sub-Saharan Africa. Their total debt may not appear large in absolute terms. However, in relation to the size of their economies and of their foreign trade, their debt represents a considerably higher burden. Furthermore, there is little doubt that the debt problem of Sub-Saharan Africa, particularly of the low income countries, is not simply a short-term liquidity crisis, but has structural roots. It should therefore be internationally recognized that a crucial prerequisite of any policy and structural reform package for Africa should be that it leads to a reasonably quick resumption of growth in those economies.

8. The Commission believes that what is needed therefore is a major new step, involving the full write-off of the bilateral official debt of the poorest African countries, the extension of the principle of debt forgiveness to other African countries that may be less poor but are still heavily indebted, and the refinancing on concessional terms of the nonconcessional bilateral official debt, as well as the multilateral debt of all countries concerned.

9. Longer Term Development Finance. In the long run, the countries of the South should be more than able to generate enough savings for investment from their own resources. Their basic thrust must be a maximum possible self-reliance, backed by effective measures to prevent capital flight abroad. However, in the initial stages of the resumption of growth, and particularly for the poorest and least developed countries, flows of long-term development finance will be needed.

10. Past experience shows that this will not be supplied by the private sector. The Commission believes that the international system should therefore provide an adequate volume of external capital to the developing countries, on terms that would not lead to unsustainable debt servicing difficulties in the future, with reasonable certainty and predictability, and under appropriate conditionality, excluding ideological pressure.

11. For this, several decisive steps are needed. Developed countries should meet the target of 0.7 per cent of GDP for official development assistance as adopted by the U.N. in 1968. Multilateral assistance - including concessional assistance - should be increased and its share in overall financial flows enlarged. Multilateral institutions such as the World Bank should assume a larger role in development finance. Regional development banks should also have a large and vigorous role, as they are, by their structure and philosophy, particularly geared to the needs and aspirations of developing countries.

12. The expansion of the role of the IMF and the World Bank should be accompanied by a depoliticization of their operation. Conditionality should reflect the best technical advice on how to achieve adjustment and growth, not - as at present - the ideological biases of the donors. This is crucial inasmuch as the 1980s have witnessed a sharp increase in conditionality associated with the provision of external finance (in the

context of stabilization and structural adjustment programmes) by these two institutions to developing countries. Cross-conditionality - the application by one institution of the conditions the other stipulates, which is now a practically universal fact of life - has left developing countries with almost no discretion to pursue policies of their own. The results, however, have been little short of disastrous.

13. For countries that have adopted adjustment programmes, the current mechanisms and norms used to judge and monitor their performance need to be reviewed. They must assure that the evaluation is based on an objective analysis of the situation and not influenced by the ideological prejudices of the donors. The international credit mechanism is in the final analysis a highly political mechanism. Creditors are in a stronger bargaining position and are often able to impose their views on the borrowers. Only a depoliticization of the process, through independent international evaluation of development performance, can inspire the respect and confidence of both donors and recipients.

14 <u>In this regard, the Commission believes that the setting up of a panel of experts, independent of the international financial institutions, but operating as advisory committees to them, as was done in the 1960s under the Alliance for Progress programme for Latin America, can be an important step in this direction</u>.

15. The countries of the South will need to make a concerted effort to tap international capital markets for development. At present, savings in the world economy are concentrated in private hands, notably in West Germany and Japan. Most developing countries have only limited access to private capital markets on commercial terms because they are considered to be insufficiently creditworthy. Furthermore, for many developing countries, the going commercial terms are simply too onerous.

16. There is thus an urgent need for new mechanisms reconciling the investors' requirement for a reasonable return and the developing countries' need to avoid an excessive debt burden. The Commission believes that an International Trust Fund should be created to raise funds in private capital markets and lend them to developing countries.

17. Uncertainty and instability in the world economy have greatly increased. It is therefore essential to have adequate international arrangements to assist developing countries which experience unexpected shortfalls in their foreign earnings or sharp increases in their external payments from rising interest rates or changes in exchange rates. Developing countries lack the ability to withstand such shocks. They cannot avail themselves of buffeting mechanisms, such as futures markets. They need internationally created safety nets.

18. Agreement on the need for such arrangements has existed since the early 1960s, when the IMF introduced a Compensatory Financing Facility. Since then, however, the trend has been to increase the conditionality attached to assistance under the scheme and to reduce access limits. The Commission believes that it should be a central priority of reform of the international financial system to remove the conditionality now attached to compensatory financing, and to return the scheme to its original conception of quasi-automaticity, at least in offsetting foreign receipt losses suffered by developing countries due to factors outside their control.

Money and Development

19. The world monetary system is in disarray; on that there is general agreement. It is not always equally perceived that the most negatively affected countries are those of the South. The world today lacks an orderly mechanism for creating international liquidity, and this is becoming a major problem

for the world economy as a whole. On the other hand, there is a growing privatization of international liquidity, and this particularly hurts the countries which do not have high credit ratings. Thus, while there is ample liquidity in the hands of developed country financial agents, the developing countries have no access to it.

20. And yet, there is a monetary instrument, the SDRs, originally conceived as future reserve assets for the international monetary system, whose use could both introduce a measure of multilateral control over international liquidity creation and allow the developing countries the possibility of building foreign exchange reserves without having to run trade surpluses or incur foreign debt. <u>There is urgent need both for a reaffirmation of the role of the SDRs as international reserve assets, and for agreement in the short run on the allocation of a modest amount of SDRs to developing countries over and above their IMF quota. In the longer run the goal of the international community should be to transform the International Monetary Fund through a fundamental restructuring into a genuine world central bank.</u>

21. Such an institution should be capable of ensuring that the settlement of global imbalances in external payments promotes optimum non-inflationary growth in the world economy, and have a built-in mechanism to facilitate an orderly transfer of resources from the surplus countries of the North to the deficit countries of the South.

Trade and Development

22. The prevailing approaches, rules and disciplines of the world trading system, embodied in the General Agreement on Trade and Tariffs, are based on the notion of open, multilateral, transparent and non-discriminatory trading. However, developing countries face an entirely different reality when trading with

the North. Protectionism in the industrialised countries now affects a very large proportion of the exports of processed products and manufactured goods from developing countries.

23. Protectionist barriers exist in various forms: explicit departures from GATT, such as the Multi-Fibre Arrangement in textiles and clothing; 'grey-area' measures, such as 'Voluntary Export Restraints' and 'Orderly Marketing Arrangements', which circumvent GATT rules and principles; restrictive 'Codes' agreed by groups of developed countries and then presented on a take-it-or-leave-it basis to the developing countries; and the more transparent tariff barriers within the framework of GATT which discriminate not between countries but by sectors or by the degree of processing,

24. Equally, a distinct tendency has appeared recently towards the formation of large trading groups among developed countries. The most notable instances are the Canada-United States Free Trade Agreement of December 1987 and the 1987 Single European Act which commits the countries of the European Community to the creation of a unified market by the end of 1992. It would be wholly objectionable if these developments result in reduced access to developed country markets for the exports of the South.

25. <u>The Commission thus believes that the international community should agree that reasonable safeguards should be introduced to preserve, and indeed expand, the preferential access of the less developed countries to these extended regional markets of the North.</u>

26. <u>The Commission also believes that a reformed international trading system must lead to improved market access, enabling developing countries to expand their share of world trade in products in which they have a distinct comparative advantage; it must as well provide increased support for the expansion of</u>

trade among developing countries themselves. It should include the promotion of sustained development in the South as a central objective and consequently reiterate the notion of differential and more favourable treatment and limited reciprocity. In the long run, the objective must remain to set up an International Trade Organization, with a considerably expanded brief as compared to GATT and charged essentially with administering the reformed trade system.

27. More specifically, trade in textiles and clothing must be returned to GATT rules and disciplines as a matter of urgency. Equally, sector-specific quantitative restrictions in, for instance, steel, leather goods, footwear, and consumer electronics, which discriminate against, and thus limit, manufactured exports from many developing countries, must be eliminated.

28. The Uruguay Round of Trade Negotiations. A satisfactory outcome in some of these areas in the current Uruguay Round of trade negotiations is linked to reaching a comprehensive agreement on safeguards. Non-discrimination in the application of safeguards is a *sine qua non* of such an agreement. There has, over the last few years, been a convergence of views on several aspects of safeguards, including the desirability of adequate transparency, consultation and multilateral surveillance; limited duration of action; and the progressive liberalization of application. Agreement on these aspects should be pursued vigorously. On the other hand, any attempt at introducing selectivity in the application of safeguards would be a highly retrograde step, and should be resisted.

29. It is also very important for the South to have a clear and united stance vis-à-vis the so-called 'new issues' in the Uruguay Round. On trade in services, it is the Commission's view that the application of traditional norms for trade in goods to the area of services could seriously undermine the

ability of developing countries to promote and regulate their service industries to further their development prospects. Services such as transport, communications, banking, insurance, health and education have always been regarded as critical for sustained development. Banking and insurance in particular have major implications for macroeconomic management, and their unregulated liberalization could impinge seriously on the ability of developing country governments to manage their national economies.

30. To be consistent with the objective of promoting development, any new multilateral framework for services must not affect the ability of developing countries to provide a reasonable measure of protection to service industries considered vital for development. Simultaneously, the new regime must also facilitate the growing participation of developing countries in the world export trade in services.

31. The inclusion of 'trade-related investment measures' (TRIMs) on the agenda for the Uruguay Round also involves serious threats for the developing countries. By restricting the freedom of developing country governments to regulate foreign investment, it is essentially an attempt at introducing a multilateral system which would further strengthen the presence and power of the transnational corporations. Clearly, all countries need screening procedures to block unacceptable and counterproductive activities or projects and to modify the terms of their operations to make them consistent with national development objectives.

32. Reform of International Commodity Trading. The Commission attaches special importance to the need to reform international commodity trading. Most of the countries of the South still derive the bulk of their foreign exchange earnings from the export of primary commodities. A renewed effort towards meeting the current crisis in commodity markets in ways that will

prevent its recurrence is urgently needed. The setting up of mechanisms to regulate the international commodity economy should be high on the agenda of the world community.

33. The crisis in commodities is as dramatic as that in the international financial system, and the rationale for concerted action leading to permanent regulatory mechanisms to ensure stable and remunerative prices is as strong. In this context, the Commission believes that the essential goals of the Integrated Programme for Commodities remain valid, namely improvement of the terms of trade for commodity-exporting countries, stabilization of commodity prices, compensation for commodity export shortfalls, and commodity development through increased productivity, domestic processing and developing country participation in marketing and distribution.

34. The South and Perestroika. The South should also follow closely the trends towards the integration of the USSR and the socialist countries of Eastern Europe in the world economy as a consequence of perestroika. This is a development of truly historical proportions, which in the long run could offer enormous opportunities for building a better world for all. In the shorter run, however, the prospects are more ambivalent.

35. The economic reforms in the Soviet Union and the greater freedom for Soviet enterprises to enter into foreign trade transactions will lead to their seeking more competitive sources for their imports. This could place some developing countries at a disadvantage vis-à-vis Western suppliers. Conversely, in the short run, the stated objective of the USSR of significantly increasing its imports of consumer goods could open possibilities for those countries of the South that are in a position to export consumer durables and light manufactures at competitive prices. Also, the bilateral balancing which has been a feature of trade between socialist countries and developing countries in the past has limited the scope for trade. Should

the socialist countries introduce progressive multilateralization of their trade and payments arrangements, this could help to expand the scope for the growth of trade, even though it may create some transitional problems for developing countries heavily dependent on markets in the USSR and Eastern Europe. In the short term, increased competition from Eastern Europe for the surplus savings in the world economy could create some problems for the developing countries. However, in the longer run, the entry of the USSR as a member of the international financial institutions could contribute to greater balance and objectivity in the functioning of these institutions. The USSR and other East European countries would need to devise mechanisms to help developing countries to deal with any transitional difficulties they face.

36. There is little question that sustained growth in the South will need a substantial expansion of exports to the North. Furthermore, as world trade in the future is unlikely to grow as fast as during the 1945-79 period, the accommodation of exports from developing countries will require more deliberate action by developed countries to keep their markets open to Third World products.

Global Economic Management: The Revitalization of the U.N. System

37. True peace and security in the world cannot be assured without action to make the international economic environment more equitable, predictable and supportive of development in the poorer parts of the world. Such action has to be a global responsibility. The United Nations, as the principal forum of the global community, should have a central role in steering the world towards it.

38. The Commission believes that ways must therefore be found for the world community, through the United Nations and at the highest level of world leadership, to make periodic assessments

of global trends and their consequences for development as well as the environment. We recommend that an annual summit of a representative group of nations from both North and South should be convened by the United Nations for this purpose. It should set guidelines for action by the UN and its agencies and other important components of the global system.

Peace, Environment and Development

39. To turn swords into ploughshare has been one of mankind's noblest and most enduring dreams. In recent times, the hope has been that part of the vast sums spent on preparations for war would be diverted to the war against world poverty. An opportunity for making this a reality is offered by the thaw in relations between the two superpowers and the start of a process of disarmament. The need for this conversion is made more acute by the recognition of the high cost of preserving the environment and the global habitat while at the same time allowing the developing countries to achieve an adequate rate of growth.

40. The Commission believes that a Peace, Environment and Development Fund should be established to which a part of the resources freed by the scaling down in arms budgets should be directed. This Fund should be used to assist developing countries meet their technological needs, through such means as the establishment of centres and schemes of scientific and technological training, including in-firm training, and collaboration between institutions of learning and research; and to finance initiatives aimed at protecting the environment in the developing countries through the introduction of technologies that increase efficiency and productivity and improve living standards without threatening the ecological sustainability of development.