



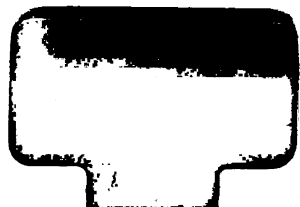
MEMOIR

SEMINAR ON TRADE AND PRICING POLICIES
IN LATIN AMERICAN AGRICULTURE

Cartagena, Colombia
27-30 March, 1987

ECONOMIC DEVELOPMENT INSTITUTE OF THE WORLD BANK (EDI)
INTER-AMERICAN INSTITUTE FOR COOPERATION ON AGRICULTURE (IICA)

PROGRAM IV: MARKETING AND AGROINDUSTRY





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ECONOMIC DEVELOPMENT INSTITUTE OF THE WORLD BANK (EDI)
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PROGRAM IV: MARKETING AND AGROINDUSTRY

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PART ONE: INTRODUCTION

- I. Preface
- II. Seminar Program
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I. PREFACE

The economic stability and growth of developing countries have been influenced more and more by the rapid and very significant changes occurring in the world economy since 1980. The countries of Latin America and the Caribbean (LAC) have been particularly hard hit by this phenomenon. Most of these countries are entering the second half of the decade weakened by the accumulated effects of domestic policies formulated on the basis of old models of development, overburdened by their conditions which are reducing their export earnings. These conditions affect the agricultural sector in particular. At the same time, they are factors which severely limit the recovery and future development of this sector.

The gravity of this situation caused the Inter-American Development Bank in its report on the "Economic and Social Progress in Latin America" of 1986 to make "Agricultural Development" a special topic of consideration, and the World Bank to dedicate part of its "Report on World Development 1986" to the analysis of "Trade and Pricing Policies in World Agriculture".

Faced with the problems described above, and with this useful background documentation on hand, the Inter-American Institute for Cooperation on Agriculture (IICA) and the Economic Development Institute of the World Bank (EDI), considered it useful and timely to summon together a group of high level experts to discuss the present situation and the outlook for the region's agricultural trade of on the world market. More specifically, the group was to spand their effect on both the overall and sectoral development of the economies of the LAC countries, as pertains to domestic and foreign macroeconomic policies. This would also permit the exchange of experiences gained from introducing sectoral policies seeking to reactivate agricultural development and to weigh their costs and benefits from a political, economic and social point of view. On this basis, promising areas and fields could also be identified for joint international and regional action which promote cooperation and integration throughout the continent.

This meeting took place from March 27th to 30th, 1987, in Cartagena de Indias, Colombia, during the "Seminar on Trade and Pricing Policies in Latin American Agriculture", and the results are outlined in this Aide-Memoire. The main body of the document contains the general conclusions and summary of the Seminar (as well as those of the sessions on specific topics), and also includes transcripts of some of the formal presentations and ad hoc working documents. Meeting participants were invited personally as professionals, the papers and summary contained in this document do not necessarily represent the opinions or positions of IICA, EDI or the organizations for which the participants work.

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II. SEMINAR PROGRAM

March 26 - Thursday

(P.M.) REGISTRATION

March 27 - Friday

(A.M.) OPENING SESSION

Speech by the Director General of IICA
Dr. Martín E. Piñeiro

Opening address by the Minister of Agriculture
of Colombia
Dr. Luis Guillermo Parra

ORGANIZATION OF THE SEMINAR

Dr. Jacques Kozub (EDI)

INTRODUCTION OF PARTICIPANTS

Dr. Rodolfo Quirós (IICA)

SESSION I

The Effect of Macro-economic Trade and Pricing Policies on
Agricultural Development: A Retrospective View

Discussion Leader: Dr. Cassio Luiselli
Speaker: Dr. Alberto Valdés

(P.M.) SESSION II

International Economic Conditions for Agricultural Trade:
Working Towards Stability and Cooperation

Discussion Leader: Dr. Rodolfo Quirós
Speaker: Dr. Donald O. Mitchell
Commetators: Dr. Luis Guillermo Parra
Mr. Marcelo Regunaga

March 28 - Saturday

(A.M.) SESSION III

International Economic Conditions for Agricultural
Trade: Present Situation

Protectionism and Competition
The Root of Instability

Discussion Leader:	Dr. Cassio Luiselly
Speaker:	Dr. Alberto Valdés
Commentators:	Dr. Anandarup Ray
	Dr. Bernard Yankey

(P.M.) SESSION IV

Options for National Policy for Change

Trade Policy
Monetary and Fiscal Policy
Assigning Resources by Sector

Discussion Leader:	Dr. Carlos Pomareda
Speaker:	Mr. Gert Rosenthal
Commentators:	Dr. Guillermo Díaz
	Mr. Carlos Vidali

March 30 - Monday

(A.M.) SESSION V

International and Regional Mechanisms of Cooperation

Agreements and Negotiations
Regional Integration and Cooperation

Discussion Leader:	Dr. Jacques Kozub
Speaker:	Dr. Carlos Ml. Castillo
Commentators:	Dr. Dario Sarachaga
	Mr. Felipe Ortiz

(P.M.) SESSION VI

Managing Tools for Agricultural Change

Improving Incentives
Weaknesses and Deterioration of Markets
Balancing Costs and Benefits

Discussion Leader: Dr. Francisco Aguirre
Speaker: Mr. Luccio Reca
Commentators: Dr. Gustavo Saberbein
Dr. David Ibarra

(P.M.) CLOSING SESSION

Seminar Conclusions
Dr. Carlos Manuel Castillo

Closing Remarks by the Assistant Director for the
Department of Latin America and the Caribbean - World Bank
Dr. Francisco Aguirre Sacasa

III. WORKING DOCUMENTS

As mentioned in the preface, the basic working documents for the seminar were the 1986 Annual Reports of the Inter-American Development Bank (IDB) and the World Bank, respectively. Those and the following reference documents were distributed to Seminar participants.

A. WORKING DOCUMENTS

1. INTER-AMERICAN DEVELOPMENT BANK. Informe de Progreso Económico y Social en América Latina. 1986 Report. Part II: "Desarrollo Agropecuario", pp. 75-204.
2. WORLD BANK. Informe sobre el Desarrollo Mundial 1986. Part II: "Políticas Comerciales y de Precios en la Agricultura Mundial", pp. 70-194.

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2. WORLD BANK. "Manual sobre Negociaciones Comerciales Multilaterales: Agricultura". (Mimeo., 1987).
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4. CASTILLO, C. Ml. The Economic Integration of Central America in its Next Stage: Problems and Opportunities. (IDB/INTAL), (Buenos Aires, 1986).
5. COOPERATIVE AGREEMENT SAG AND P-IICA-UNDP-IBRD. Los Países Productores de Cereales ante la Crisis Agrícola Internacional. (Buenos Aires, 1987).
6. INTER-AMERICAN INSTITUTE FOR COOPERATION ON AGRICULTURE, ECONOMIC DEVELOPMENT INSTITUTE, WORLD BANK. El Sector Agropecuario de América Latina y el Caribe y la Crisis Financiera Internacional. (San José, 1986).
7. DE JANVRY, A. "International Economic Development and U. S. Agriculture". The Benjamin H. Hibbard Memorial Lecture Series, Department of Agricultural Economics, University of Wisconsin. (Madison, April 10, 1987, mimeo.)

8. ORTIZ, R., F. "La Crisis Agrícola Internacional: Algunas Proposiciones de Reforma". (Santiago, 1987, mimeo.)
9. PAZ CAFFERATA, J., HECKERMAN, D.G. and ROIRDAN, J.T. "Mecanismos para Estimular la Producción Agropecuaria Compatibles con Políticas Heterodoxas en el Campo Monetario de Gestión, de Deuda Externa y de Comercio Internacional: El Caso de Perú". Document presented at the Annual Meeting of the American Association of Agricultural Economics. (Lima, 1987, mimeo.)

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PART TWO: FORMAL PRESENTATION AND GENERAL SUMMARY

- V. Opening Address by Dr. Martín E. Piñeiro, Director
General of IICA
- VI. Address by Dr. Luis Guillermo Parra,
Minister of Agriculture of Colombia
- VII. Summary and General Conclusions of the Seminar,
Dr. Carlos Manuel Castillo

V. OPENING ADDRESS BY DR. MARTIN E. PIÑEIRO AT THE SEMINAR ON AGRICULTURE TRADE AND PRICES IN LATIN AMERICA

It is a great honor to welcome you and thank you for your willingness to take a break from your daily tasks and participate in these meetings and discussions.

I would also like to express my thanks to EDI of the World Bank and especially to Mr. Jacques Kozub whose support has made it possible to organize these sessions, also to the participants from other international agencies, such as the OAS, FAO, IDB, ECLA and the Caribbean Bank, who have joined us here today.

We are fully convinced of the importance of this type of meeting, especially at this time, as a means for facilitating the exchange of ideas and developing a specifically Latin American and Caribbean approach to the search for solutions to problems which, in most cases, are common to all our countries. Furthermore, I believe that the personal nature of your participation and the role of IICA as a technical agency will add to the informal nature of these meetings and provide for a direct exchange of views which, we hope, will result in a more fruitful and searching dialogue.

The participation of IICA in organizing this event is a clear indication of the new institutional orientation adopted for us by the Inter-American Board of Agriculture under its new medium-term plan for 1987-91.

This plan proposes bringing the institute into line with the current needs of Latin American countries with a view to: giving priority support to their efforts towards agricultural development by expanding the used modern technologies, increasing production efficiency and moving ahead with the process of regional integration.

With this in mind, IICA's current strategy is to reorganize itself as an institution and identify specific issues.

The main thrust of these changes is to define five action programs and strengthen the management of these programs with a view to developing appropriate technical standards in the five areas covered by these programs, i.e. analysis of agricultural policy and technology, rural development, marketing, agroindustrial activities, and plant and livestock health. Similarly, within each of these areas, IICA will be concentrating its efforts on the type of activity in which it has the most experience and offers comparative advantages for cooperation with member countries: institutional development, multinational technical cooperation, and project preparation and implementation.

This action, which merely continues and emphasizes activities already undertaken by IICA -- now approaching its 45th anniversary -- I would like to stress one central objective of PMP which is very closely related to the subject of this seminar: "The need to expand the role of agriculture in the countries of the region".

At this point in time, when the terms of trade for agricultural commodities have deteriorated to one of their lowest levels, many countries are tempted to disregard the economic growth potential of agriculture. I believe it would be a grave error if this belief led to policies adversely affecting agriculture and preventing it from achieving its potential.

On the contrary, we feel that this economic crisis, despite its unprecedented accumulation of problems stemming from stagnation and the external sector, offers an excellent opportunity for agriculture to exercise a revitalizing influence, given the fact that it does represent a major share of exports in most Latin American countries.

Yet defining a clear and effective strategy for developing agriculture is more difficult than in the past, and calls for greater imagination and expertise. Agricultural competitiveness depends exclusively on the availability of natural resources, but to-day it requires increased inputs of the appropriate technology to develop those resources.

For agriculture to remain the important source of foreign exchange needed for development, improvement in production, transfer of technology and the supply of inputs should become its key components, if it is to participate effectively on international markets.

Furthermore, existing macroeconomic constraints in most countries of the region make it necessary for the design of agricultural policies to be compatible with the overall needs of the economy. Against a background of inflationary pressures, budget deficits and balance of payments problems, recessions and declining employment, it would be quite unthinkable to develop one sector at the expense of another, by favoring industry over agriculture -- as has often been the case in the past so far -- or agriculture over industry.

As I said initially, this type of meeting is of particular importance in the search for solutions to the current problems of agriculture in the region.

Similarly, I would also like to point out that IICA, at the behest of the OAS, is organizing the ninth Inter-American Conference of Ministers of Agriculture, which will take place in Ottawa from August 30 to September 5. Its main theme will be agricultural modernization, international trade and price policy within the framework of regional integration and the present international economic situation.

Given the nature and high level of that conference, and the importance the Government of Canada, as host country, has granted it, we believe it will provide an excellent opportunity for Ministers of Agriculture from the region to exchange ideas, formulate proposals and, we hope, adopt common criteria for a regional policy that will lead to concrete decisions.

For us, therefore, the holding of this high-level seminar on agriculture trade and prices in Latin America is important for two reasons.

First, as I said before, it is part of IICA's ongoing activities -- in line with PMP policy -- and is intended to provide opportunities for discussing agricultural problems in the region.

Second, we hope that it will be of considerable help in preparing the Inter-American Conference of Ministers of Agriculture not only through the specific inputs which are bound to emerge from the various papers presented at the Seminar but also from the discussions between participants. It will no doubt help clarify the thinking of the region on these issues. This, in itself, will be an invaluable addition to the technical documents which IICA is preparing for the Conference.

I would now like to share with you some ideas on certain subjects which seem to me of particular relevance to the discussions at this Seminar. They concern: 1. the international trade situation; 2. the relationship between agriculture and the rest of the economy; 3. price policies; 4. regional cooperation and integration.

1. The critical situation of international trade and prices for most agricultural products has become a matter of increasing concern in recent years in view of its impact on agricultural production and the constraints it imposes on the range of possible agricultural policies available to countries in the region.

The problem, which is bound to be discussed in detail in the forthcoming sessions and which is essentially complex, can be said in very broad terms to have two basic causes: on one hand, there is a weakening of demand, unrelated to any decrease in food needs, but resulting from a decline in the purchasing power of the underprivileged sectors which in turn stems from a reduced rate of economic growth.

On the supply side, food self-sufficiency policies protecting domestic agriculture have been combined in many countries with the vigorous technological development occurring in the postwar period, thus generating major incentives for a sustained increase in the output of many items. The most obvious example is the EEC countries which, as a result of a policy decision to achieve food self-sufficiency, developed a series of protective mechanisms and incentives, which not only enabled them to achieve their initial objective, but also generated huge surpluses requiring vast subsidies for their sale abroad and adversely affecting production in other countries.

But while this may be the most extreme case as regards market impact, many countries have developed "agricultural import substitution" strategies based on the spread of technology and protectionist policies. China and India are obvious examples.

The substitution process has been made worse by the growing number of synthetic products. The most dramatic example at the moment is sugar, but others may arise.

The consequence of these phenomena for both demand and supply is that there has been an unprecedented accumulation of the stocks of most agricultural products, which in turn has led to a sharp decline in prices restricting any possible growth in the region's agriculture and general economy. The nature of international markets has changed with a marked departure from free-trade principles "since today the levels of supply, demand and prices are increasingly determined by political decisions rather than market forces and mechanisms".

The situation has become so serious that, for the first time in the history of GATT, its members have decided to include a discussion of agricultural trade in the next round of multilateral trade negotiations.

No short-term solutions can be expected, the countries concerned will have an opportunity to introduce basic changes in the factors affecting agricultural trade. Whether this opportunity is taken or not will depend not only on the negotiating power of these countries as a whole, but also on the technical capacity of their negotiators, especially those representing the public agricultural sector.

2. The relationship between agriculture and the rest of the economy is the second aspect that conditions agricultural policy. There is no doubt that, in most countries of the region, sector policy depends increasingly on macroeconomic variables.

As agriculture becomes more commercial and intensive, absorbing inputs and credit and trading its output, its economic performance and behavior are becoming more dependent on the prices of goods and services supplied by other sectors of the economy that are not bound by agricultural policy.

Exchange rates, interest rates, tariffs and other key economic variables are frequently determined without reference to the requirements and needs of the agricultural sector, and without any input from the representatives of the public sector in agriculture.

Similarly, there is frequently no coordination between industrial policy and agricultural policy -- particularly as regards technology -- and there is often an imbalance in the degree of liberalization within both sectors, reflected in input/product price ratios that impede the introduction of more advanced techniques.

Similarly, the internationalization of agriculture through input, commodity and capital markets is taking the control of the variables affecting the activity away from the sector itself, as well as from individual national governments. International prices and external interest rates, on which the national economies of Latin American and Caribbean countries have no influence, have a tremendous impact on these economies.

Many of our guests who hold, or have held public office will undoubtedly be able to expand on these points, which are highly relevant and suggest the need for a thorough reconsideration of the present institutional organization and the decision-making mechanisms which affect economic policy.

The existing institutional models in most Latin American countries tend to restrict the decision-making powers of civil servants responsible for agriculture even in matters that lie within their field of competence. For this reason it is necessary to design new decision-making mechanisms and structures that meet the needs of modern agriculture.

3. The concept of price policies, I believe, should be extended to include both products and inputs, as well as investment policy. In other words, it should include all factors affecting agricultural profitability and constituting economic incentives for production.

These constraints, together with the consequent shortage of resources, mean that these resources must be managed much more carefully and strictly than in the past. Nowadays decisions as to what products and/or productive sectors are to be selected for development subsidies, as to where public investment in agriculture and credit is to be concentrated, and as to what competitive action should be taken on external markets, call for careful preliminary analysis of economic, financial and social costs and benefits, for the opportunity cost of a mistaken decision is all the greater where resources are more limited.

The heterogeneity of the countries in the region as regards their conditions and problems makes it impossible to apply valid recommendations from one country to another, and still less to seek to impose general remedies. The lessons learned from the history of Latin America are eloquent enough to discourage us from repeating similar mistakes.

There is, therefore, an urgent need to emphasize the study and preparation of agricultural policies in the countries of the region, especially in relation to the use of incentives and the allocation of resources. The new approach to external financing through sector lending, which makes it necessary for countries to define sectorial measures, as a form of political conditionality, as well as their investment programs, is a further step in the same direction.

4. Finally, we believe that it is worth while to reflect deeply upon the opportunities offered by regional integration and cooperation under the difficult conditions that now prevail and to take advantage of a political climate which favors such initiatives.

Expanding compensated intraregional trade to avoid the use of foreign exchange, achieving a scale of operations that would justify major investment to generate new technology and the production of inputs, developing

complementary crops for food security, and designing intraregional tariff structures that would lead to the gradual liberalization of our national economies, are only some of the items on a very long list of possibilities.

We must objectively evaluate all our previous actions, and to this rich sum of experience apply our imagination and inventive capacities. This may be one of the greatest challenges to regional technical cooperation agencies.

As I mentioned before I feel that this type of meeting is of great importance and that our institute should be committed to organizing such events periodically.

I also feel that under the present difficult circumstances affecting the management of agriculture in the countries of the region, there is as yet no permanent forum where those responsible for that sector can meet to discuss its problems, exchange experiences, develop ideas and joint proposals that will establish priorities for agriculture, and help guide our regional agencies.

We hope that this seminar and the coming Inter-American Conference of Ministers of Agriculture will contribute to the achievement of these objectives.

VI. ADDRESS BY DR. LUIS GUILLERMO PARRA DUSSAN AT THE OPENING OF THE SEMINAR ON AGRICULTURE TRADE AND PRICES IN LATIN AMERICA

Ministers of Agriculture, Deputy Ministers of Agriculture, Secretaries of Planning, Presidents of Central Banks, Directors of Foreign Trade, Delegates from the twelve Latin American countries represented here, Speakers, Dr. Martín Piñeiro, Director of IICA and IICA representatives, Dr. Francisco Aguirre-Sacasa and other representatives of the World Bank, representatives of other international organizations and the seminar organizers, Dr. Rodolfo Quiros Guardia of IICA and Dr. Jacques Kozup of EDI/the World Bank.

It is an honor for me, as Colombia's Minister of Agriculture, to open this high-level Seminar on Agriculture Trade and Prices in Latin America, so kindly and so opportunely sponsored by the Inter-American Institute for Cooperation on Agriculture (IICA) and the Economic Development Institute of the World Bank at this difficult juncture in Latin America's history.

Colombia and the city of Cartagena are proud to host this Latin America seminar. Cartagena is where we Latin Americans have joined forces in the past to wage heroic battles for our independence and where we have nobly struggled in search of our identity and for ways to direct and control our common destiny. Cartagena is at Latin America's center of gravity and amply shares in the region's rich and lively cultural heritage.

It is this historical, geographical and cultural background that challenges us to ensure that this seminar leads to truly meaningful and effective action. The purpose of the seminar is to study the burning issues of our times, focusing on the current status and future prospects of Latin American trade in agricultural products in a protectionist world market. This meeting also provides a forum for the exchange of experiences from the introduction of sectoral and macroeconomic policy instruments, designed to enable the sector to play a leading, or at least a supporting role, in attaining a satisfactory level of sound growth during this period of adjustment. Colombia sincerely hopes that during this debate on development the urgent need to eliminate absolute poverty will be taken into account. Our society can no longer tolerate placing the burden of adjustment on the shoulders of the most destitute, in the form of unemployment and ever-lower real income levels. Our countries seek change, a new balance in international relations and a viable path of sustained growth.

I am quite sure that this seminar will be looking at the trade and price issue from a global viewpoint, as represented by economic relations between the industrial nations, i.e. the members of OECD, an organization of developed countries and the Latin American block, which supplies coffee, sugar, soybeans, bananas, fruits, vegetables, seafood, grains, meat and their by-products, not to mention the wide variety of raw materials that derive from the natural and entrepreneurial wealth of our region.

Faced with exchange problems, Latin America has been undergoing a painful process of economic adjustment for the past six years. This adjustment has taken its toll in terms of the region's growth and social well being. Despite on of the greatest expenditures of resources ever registered, the towering specter of debt service remains to haunt us. Latin America has, in a very short space of time, transferred an unprecedented volume of funds to the industrial countries.

Studies such as those of Bianchi, Devling and Ramos, lead us to the conclusion that the undelying cause of this transfer process is the agricultural policy of our trade partners, the industrial nations.

Although Latin American exports have increased 20% in terms of volume, there have been no increases in terms of value. The fact is that the real prices of almost all the agricultural and mining goods exported by Latin America have declined steadily over the past six years.

Interest rates, in the meantime, while declining in nominal terms, have, when deflated either by the price indexes of the developed countries or by the prices of Latin American exports, actually risen steadily in real terms to levels that are socially and politically unacceptable.

Had export prices not deteriorated, debt servicing would now be manageable in most Latin American countries. There are many factors to which we can attribute the deterioration of our terms of trade -- factors such as the low income elasticity and price elasticity of commodities and the lack of diversification of Latin American exports, which means that the burden of instability falls on a mere handful of goods. As I see it, however, it is not the increasing volume of Latin American exports that has brought about the dramatic plummeting of prices or generated the large stocks of grains, milk, meat and byproducts that are currently typical of the agricultural economies worldwide. We feel that there are two factors that distort prices and the world market. The first is the existence of high subsidies and extensive protectionism in the agriculture sector in the developed countries, resulting from heavy central government intervention. The second is the fact that -- despite this interventionism -- international market forces are allowed free play without any control mechanisms, such as could be provided through product by product international agreements. Agricultural subsidies in OECD countries, which may be financed by national treasuries, by common market budgetary funds or by the consumers of those countries, have reached disproportionate levels that encourage the formation of surpluses which are then dumped on the world market. These practices are triggering retaliation of various kinds and have brought about a price war between the United States, the EEC and Japan. This conflict is reflected in the "tactical" program that the United States is setting up to expand its exports of farm products.

Budgetary expenditures to finance the subsidies are huge, and they do not take account of the forced transfers generated by higher domestic prices. Based on this calculation, the agriculture subsidy is put at 70% in Japan, 40% in the EEC and between 22% and 24% in the United States, Canada and New Zealand.

The deterioration in commodity prices on the world market resulting from these policies has considerable but differing impacts on the countries and social groups of Latin America.

Exporting countries in the temperate zone are the victims of unfair competition with their export of grains, oilseeds, edible oils and meats, which is depressing their earnings dramatically. Countries in Latin America's tropical zone are the victims of the same kind of unfair competition with exports such as sugar, coffee, meat and rice. In this case, national policy options are limited. Imports of grains, fats and oils on the other hand, provide these countries with an element of subsidy whose potentially negative effect on local producers can be offset by national policies affording them an adequate level of protection.

The net effect of the price war is a reduction in the volume of Latin America's agricultural exports, because higher consumer prices reduce consumption in the industrial countries, and subsidies to the farm sector of these countries turn traditionally importing countries into surplus-generating countries and limit imports from other countries.

The only way then that Latin American countries can generate the trade surpluses they need to meet their debt service obligations is for them to reduce their imports, because efforts to increase exports are limited by the volumes that can be handled and by low international prices. By cutting our imports we merely intensify the contraction of the world market and limit the growth prospects of OECD countries and Latin American countries alike.

By contrast with the heavy central government interventionism in the agriculture sectors of the individual countries, concerted government action to organize the world market is weak. There are practically no product agreements that would help develop a price and market stabilization policy. In case of meat and bananas, the agreements that do exist serve as a means of disseminating information or of coordinating the price and marketing policies of their signatories.

The international sugar agreement came to an end in 1984. The international coffee agreement, covering a key product for our economies, is currently in abeyance, not for lack of willingness on the part of most producing countries, but because of the obstinate stand taken by certain countries, that by defending ideological positions have prevented the reinstatement of quotas, causing a situation that accentuates the serious imbalance of the world coffee trade. A one cent decrease per pound on the international markets actually means an US\$80 million drop in the annual earnings of the producer countries. In light of the current situation and recent price trends on world markets,

Latin America will lose US\$2.4 billion in 1987 for lack of an agreement. This amount equals 11% of the region's interest payments -- a significant figure, keeping in mind that we are referring to a single product and to a single coffee policy instrument.

Should the present trend of declining imports, deteriorating terms of trade, slow growth in commodity exports, low levels of financing by private banks (despite good support still being received from international banks) continue, aggravated by the pernicious trend of net capital outflow, I believe that we will have a scenario with little opportunity for accelerated growth in the region and one that will guarantee high levels of unemployment. Faced with this prospect, the rural poor will have no ready escape into the productive sector, which will be held back by stagnant external demand. The lack of growth will deprive a wide range of social groups of employment and income earning opportunities. Despite internal transfers among the different social groups, we will find it difficult to combat absolute poverty as effectively and as quickly as is needed, given the seriousness of the situation.

The Colombian Government is deeply concerned about the political stability in a region whose balance, when achieved, is at best precarious.

Latin America has a tradition of democracy and freedom which it is not prepared to lose. We do not want to return to the kind of government that restricts freedom and civil rights. It is our firm resolve to lead our countries along the productive path of growth and democracy.

A cutback in protection and in the heavy subsidies in the OECD, as part of an overall growth strategy, will enable the Latin American countries to reduce their protection also. The World Bank and the IMF have long urged them to do this as part of the adjustment process -- but this is something which we feel is impossible to achieve unilaterally.

Colombia actively supports the proposal that the trade distortions caused by the various agricultural policies be discussed and corrected within the context of the agenda of the new round of GATT negotiations.

Colombia actively supports the position taken by the CAIRNS group aimed at rationalizing the trading of agricultural products, providing this is accompanied by the elimination of agricultural subsidies by the industrial nations.

Colombia is sympathetic toward the specific initiatives put forward by the industrial nations with a view to eliminating subsidies on basic commodities. As an example we would mention the bill which the U.S. Administration has put before its Congress, which, if passed, will gradually eliminate direct and indirect subsidies for the production of sugar and sugar products.

Colombia believes that a more balanced model of international development will help the growth of world economy. Countries that overprotect their agriculture have a lot to answer for, not only vis-a-vis their own farmers, but also vis-a-vis humanity as a whole.

We are therefore committed to bringing about a transformation of our own development model, which will inevitably mean opening up our economies more.

This change in the development model is obviously part of the economic adjustment, but it will not be viable in the Latin American block unless there is a counterpart in trade and financial support from private international banks.

We believe that there is ample scope for negotiation without confrontation. Negotiations must, however, focus on policy-making rather than on portfolio recovery. Colombia is strongly in favor of a change in the development model. It is strongly in favor of negotiations.

We are aware that there cannot be sound growth unless mechanisms for assigning investment priorities are improved. We feel that sound fiscal, monetary and exchange policies are the cornerstones of sustained growth.

I wish to express the hope that through the hard and responsible work of its participants, this Latin American Seminar will bring forth the answers and opportunities we seek.

VII. SUMMARY AND GENERAL CONCLUSIONS OF THE SEMINAR 1/

The Problem

The Seminar focused on problems of structural adjustment which, by their very nature, can only be solved in the medium and long term perspectives. It was recognized at the outset that Latin America is still in the throes of the crisis, that in some countries stability has not yet been achieved and that where it has been, it is precarious. In the majority of countries recovery and recuperation have not yet begun.

Agriculture forms an integral part of this situation. Its relative stagnation is due to both external and internal factors. The first result from protectionist policies for production and exports (self-sufficiency, subsidies, fluctuating tariffs) instituted by industrialized countries such as the United States, the members of the European Economic Community and Japan. The second group of factors are reflected by the real rates of exchange for agricultural goods, which frequently cancel out the effect of any sectoral supportive measures; they stem from the path followed by Latin American countries, which tends to inhibit the growth of agricultural production and exports. The limiting external factors precede in time the internal ones; their impact is so strong that they alone could have brought about the present situation, though not the internal biases in evidence today. This circumstance confers on Latin America an "unquestionable moral force" in its international negotiations, and could lend political expression and support to joint positions adopted within the region.

From the beginning, it was pointed out that the crisis had impoverished the farmers of the region, as well as the majority of Latin Americans engaged in other productive activities. The questions raised at the seminar were: How can the unfavorable effects on income distribution be corrected? How can additional distortions that might derive from adjustment policies be avoided? How can the agriculture sector be transformed from a state of stagnation to a dynamic one leading to sustained recuperation and expansion?

The most outstanding observation to emerge from the seminar emphasizes the fundamental way by which macroeconomic policies in trade, exchange rates, monetary and fiscal rulings affect agriculture so that at times their influence is greater than that of sectoral policies. This explains why important decisions on agricultural policy are often made by authorities who are responsible for the economy as a whole, and not by the Minister of Agriculture or other specialized organizations. The chief conclusion on this topic was that agriculture should not be considered as an isolated phenomena but as a component linked to other productive sectors and related to the economic system as a whole.

1/ This document contains the edited transcript of Dr. Carlos Manuel Castillo's presentation on the subject.

This conclusion emphasized the need to establish in each country appropriate procedures and mechanisms that would allow macroeconomic and sectoral policies to become integrated into a coherent set of stabilizing and structural adjustment policies.

International economic conditions for agricultural trade: evolution of prices

According to World Bank figures, it is clear that the tendency during this century towards lower prices for main agricultural exports has increased in recent years as a result of protectionist policies in developed countries, so that today these prices have reached the lowest point ever registered on a long term basis. Regarding future price patterns, it was established that a prognosis for more than three to five years is not possible. It was observed that prices are now so low that further declines seem unlikely; this means that should prices fail to rise they would at least hold firm at approximately current levels.

These observations resulted in two conclusions: in view of the general uncertainty in this area investments should be made with as much flexibility as possible, in order to improve the capacity of agriculture to respond to fluctuating conditions; and, should prices not only stop falling but also register improvements, this should be considered merely as a necessary step towards agricultural adjustment. To be adequate this adjustment should result from important policy reforms, in both Latin American and developed countries.

International economic conditions for agricultural trade: the Uruguay Round of GATT

Consensus was unanimous on the enormous importance of GATT world trade negotiations for Latin America. It was noted that the talks, which will continue for four years, provide the first opportunity in modern history to discuss agriculture seriously and comprehensively within the framework of world trade. It was also emphasized that some of agriculture's principle problems are linked to world trade, and that these problems must be approached more aggressively.

It was thought that a basic criterion in pursuing the interests of Latin America during the talks is the search for multilateral mechanisms. This criterion, approved during the seminar, puts multilateral concerns above unilateral partial and transitory resolutions that are subject to change, and limited in their effectiveness.

Reciprocity in trade negotiations received special attention: It was recommended that Latin America agree to such measures in the hopes that the region would then stand a good chance of receiving better treatment by the three principle world trading blocks during the negotiations. It was further noted that the search for reciprocity on a product-by-product or sector-by-sector basis was not the most advisable. An intersectoral approach, based on reciprocal concessions in service and manufacturing sectors as compensation for

trade advantages in agricultural products, was advised. The recommendation to concede reciprocity was received with interest, although some participants expressed doubts as to the real benefits of such a policy to Latin America.

Options in national adjustment policies

Seminar participants acknowledged that general long-term considerations notwithstanding, a structural change is needed, in the strictest sense, where a permanent, noncyclical resource gap exists. With this criterion in mind, data regarding the Latin American experience from 1980 to the present was examined. This revealed an initial pattern of recessive adjustment, and a later phase of prolonged, unabated stagnation, linked to structural weaknesses in the economy. Structures were found to be particularly weak in the export sector, with possible failures in the policies adopted on a national level.

It became evident to the participants that an essential requirement for the adjustment process consists in bringing the foreign debt service into line with the capacity of indebted countries to pay, and at the same time allowing debtors to retain sufficient resources to expand production, exports and employment. This expansion should occur with a concurrent and appropriate increase in internal demand, a reorientation of production towards exports, an efficient import-substitution policy, and an investment policy congruent with these objectives.

All these actions must be implemented so as to achieve adjustment with growth - defined here as an increase in production and a simultaneous decrease in the deficit of the balance-of-payments account. As the experience of some Latin American countries has proved this goal is attainable; some participants, however pointed out that adherence to a real exchange rate, rules out the possibility of maintaining real wage levels. Moreover, it was noted that adjustment with growth, as defined by the seminar, has negative repercussions that generate unemployment and worsen living conditions for certain social groups.

International and regional cooperation mechanisms

Regarding international circumstances, the seminar briefly examined various schemes such as the Generalized System of Preference (GSP), the Lomé Convention, the SGPG of UNCTAD, and the GATT Protocol of 16. In a general sense, these mechanisms were found to be inefficient means of increasing exports, especially in the field of agriculture. For this reason, participants concluded that the solution must be sought for in multilateral negotiations during the Uruguay Round of GATT.

Historically, international agreements on individual products, except in the case of coffee, have proved to be relatively inefficient mechanisms for sustaining and stabilizing prices, earnings, and market conditions. Management problems and a lack of compliance with the stipulations seem to be the principle reasons why the potential benefits of these agreements have not been obtained. Likewise, while compensatory funds may be useful when market conditions become

calamitous, or when natural disasters strike, their overall effect is insufficient and temporary. In both cases, these mechanisms are vulnerable to pronounced changes in supply, as well as to changes in the level, or structure, of demand.

Cooperation mechanisms, as well as regional and subregional integration, commanded most of the attention during this part of the seminar. It was repeatedly agreed that these mechanisms need to be reactivated and strengthened because they provide one of the few possibilities for Latin America to find a common solution to the crisis, and because Latin American unity is vital if the sharp divisions in world trade patterns are to be eliminated.

In reference to trade agreements among neighboring countries (for example the Central American Common Market and the Andean Pact), it was recommended that attempts be made to organize production and supply before liberating trade. The following steps were suggested: a) "relocate" production to more suitable areas, with a subregional criterion in mind; b) promote border integration, with economic as well as cultural and political goals; c) coordinate and carry out joint investments in agriculture research, modernization of markets and industrialization of production; d) procure horizontal cooperation in agricultural extension programs, so as to share experiences and expand knowledge on methods of technology transfer; e) propose an integrated institutional development, for example in the cooperative movement; f) undertake joint actions to encourage stability, employment and production among refugee groups and displaced people.

The analysis of agricultural cooperation and integration is also conducive to equally interesting short term proposals such as cooperation in the field of agriculture as, for example, between small countries and petroleum producers; between countries with temperate-zone agriculture and those with tropical-zone agriculture; and between Latin American countries with an advanced agriculture sector with raw material for export and those in Central America and the Caribbean, where these raw materials could be manufactured and exported to the United States under the Caribbean Basin Initiative. These three possibilities are based on the supply of basic food crops for Mexico and Venezuela from Central America and for the Caribbean from the Southern Cone countries, and on the processing of primary agricultural materials from Argentina or Brazil in Central America or the Caribbean, and their export to the United States.

Management of instruments for agricultural adjustment

It became evident while analyzing this theme that structural adjustment of agriculture, by its nature a medium and long-term process, is difficult to implement because of the limitations of short-term stabilization. To overcome this apparent contradiction, it was proposed that policies be amplified, utilizing standard monetary and public-spending measures, as well as those that support the stabilization process: transfer of technology, improvements in marketing systems, development and reforms in agroindustry and tax policies.

Within the framework of agricultural policy, intrasectoral matters as well as those related to other sectors and to the economy as a whole must be managed carefully. It is inevitable that this adjustment process will cause some redistribution of positions and power relationships within the economy and, more generally speaking, within the society of Latin American countries. This adjustment will not be easy to achieve, and efforts must be made to strengthen it.

The seminar participants recognized that structural readjustment loans (SALs) granted by the World Bank are useful instruments that facilitate the implementation of these programs. They are loans designed to improve the balance of payment; when complemented with sectoral financing and specific investment projects, they permit the conciliation of urgent short-term needs with those of the medium term, in a commendable manner.

Final considerations

In concluding this seminar, the participants expressed hope that the results of their deliberations would prove useful during the Inter-American Conference of Ministers of Agriculture (IABA) in Ottawa, Canada, in September 1987. This conference will provide an opportunity to evaluate the viability of the various proposals, and to consider incorporating them into economic policy so as to achieve that desirable structural change in agriculture.

The task of judging these proposals falls to the Ministers, who will decide on the best way of obtaining indispensable political consensus, both on a national and regional levels, of seeking the necessary foreign cooperation and the needed changes in the organization and management of their governments. These changes must help them redeem their constitutional responsibility to formulate and carry out agricultural policy in their countries, rather than allowing these important decisions to be made by authorities outside their own ministries, as is the case today.

PART THREE: SUMMARY AND DISCUSSION DOCUMENTS

VIII. The Effect of Macroeconomic Trade and Pricing Policies on Agricultural Development

- A. Summary of the Session
- B. Discussion Document

IX. International Economic Conditions for Agricultural Trade: Present Status

- A. Summary of the Session
- B. Discussion Document

International Economic Conditions for Agricultural Trade: The Quest for Stability and Cooperation

- A. Summary of the Session
- B. Discussion Documents

X. National Adjustment Policy Options

- A. Summary of the Session
- B. Discussion Documents

XI. International and Regional Cooperation Mechanisms

- A. Summary of the Session
- B. Discussion Document

XII. Managing the Instruments of Agricultural Adjustment

- A. Summary of the Session
- B. Discussion Document

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VIII. THE EFFECT OF MACROECONOMIC TRADE AND PRICE POLICIES ON AGRICULTURAL DEVELOPMENT

A. SUMMARY

Presentation

The central theme of this topic is the analysis of the way variations in agricultural growth interact with the development of the rest of the economy. Consequently our considerations should focus on the means of integrating the sectoral applications of general policies and on the effect this would have on the development of the agricultural sector.

In a long-term perspective, we must remember that, whatever may eventually happen in policy formulation, the structure of incentives will have a substantial impact on the sector's growth, but this growth will depend, primarily and increasingly, on modalities assumed by macroeconomic and trade policies that do not necessarily correspond to the so-called agricultural policies. In this respect, exchange rate, fiscal and financial policies have indirect repercussions that in many cases can neutralize our endeavors at the specific level of the agricultural sector.

Our analysis is limited to the behavior of an agricultural development policy in a given external time frame. In this context, the exchange rate and all related to it plays a central part in determining profitability of production in the agricultural sector, especially in relation to tradable activities that are sensitive to international prices, exchange rates and trade policy 1/.

Sectoral growth requires long-term movement of resources (labor and capital), if it is to adjust to the possibilities of profitability in the various sectors of the economy.

In today's economic scenario, development of the agricultural sector can play a very significant role, since Latin American countries must revitalize their tradables sector, not only to meet their external debt service payments but to reactivate their economies as well. Our position in this study is that the potential of agricultural development will be determined mainly by whatever happens in the real rate of exchange for the sector, apart from institutional and technological changes and public spending for infrastructure.

1/ According to some estimates, in the cases of Argentina, Colombia and Chile, tradables account for approximately two thirds of the agricultural activities.

For purposes of analysis, it is assumed that the sector's ability to compete will eventually be determined by the real exchange rate (RER), which in essence is the ratio of the economy's internal prices of tradables to those of nontradables. Accordingly, the real exchange rate level is the basic signal from the standpoint of long-term incentives.

The instruments that a government can employ to influence the RER --aside from changing the nominal exchange rate of course-- may be grouped into three categories: trade policy, the policy governing external capital movements and fiscal policy.

The background and available studies on Latin America seem to corroborate the assertion that both macroeconomic and trade policies have had an adverse effect on RER performance for the agricultural sector, which would seemingly explain the implicit adoption of an anti-agricultural bias and a largely anti-export bias.

The foregoing assumption is confirmed, for instance, if we consider the amount and distribution of industrial protection costs and policies, which have entailed an implicit tax on the sector of agricultural tradables. Such implicit taxation obviously cannot be removed through changes in the nominal exchange rate alone. Instead, it is a question of acting through mechanisms that will affect relative prices in the remaining sectors, for if the relative profitability of the latter remains unchanged, the resources earmarked for agriculture will end up bolstering these other sectors.

Fiscal policy performance has a perceptible effect on the RER, which is closely linked to the size of the public sector, the deficits that may occur and the means used to finance them. Thus for instance an upsurge in public spending will exert great pressure on the nontradables sector and will end in a lowering of the RER. As a result, the profitability of tradables will decline, in relation to what could be obtained with a smaller government deficit.

Similarly, external capital movements can have a very substantial impact on the RER. A policy of sizable external indebtedness for instance can have a marked effect, depressing the RER considerably. On the other hand, exceptionally high receipts in foreign exchange over a period of years can also depress the RER appreciably if the nominal exchange rates remain without significant changes.

In sum, the main variables that affect the RER are: trade policy, external capital flows, fiscal policy, exogenous changes in the terms of trade, etc. Therefore it will be necessary to explicitly incorporate the effect of the changes that these policies introduce in the agricultural sector, when the time comes to conceive and design agricultural development strategies.

An attempt was made in the 60's and 70's to gauge the effect of sectoral policy and the RER on the protection extended to different agricultural products in some countries of the region 1/. It showed the impact of macroeconomic and trade policies to be relatively greater than that of the agricultural or sectoral policies. We may therefore conclude that any historical analysis of the agricultural sector would be quite incomplete unless it specifically incorporated data on the direct and indirect effects of macroeconomic and trade policies.

Consequently, in considering the design of policies for agricultural sector development, it seems necessary to measure the degree of distortion in the RER in the light of different trade policy options, of policies governing external capital flows and of the various international price forecasts, to see how they affect the incentives for agriculture. That is why it is important under the present critical circumstances to assess the way stabilization and structural adjustment policies are affecting agricultural sector development and vice versa --in other words, the role assigned to agriculture in macroeconomic and trade policies.

A factor that deserves mention and should be taken into account is an area that is complex and difficult to analyze: the implications, at the distribution level, of development strategies in this context. How do we compensate the most backward population strata while motivating the agricultural sector?

Comments

Some Latin American countries have experienced the negative effects on the RER even in a foreign exchange boom situation. In the case of Venezuela, although efforts were made to stabilize part of the surge in foreign exchange resulting from the oil boom, they were not very successful, and the end result was an adverse impact on the non-oil tradable sector. Even though the financial flows or resources were channeled toward the agricultural sector, they failed to produce a significant upturn in production, because the non tradable sectors --by offering a higher rate of return-- attracted a real transfer of productive factors. The overvalued exchange rate and some rather inept macroeconomic policies triggered pressures on the RER that affected all of the non-oil tradables.

One of the most pertinent considerations to emerge from this subject in terms of future action is how to enable the different economic sectors to link up the sectoral policies in a manner consistent with the viewpoints or equilibrium of macroeconomics. From another point of view, it

1/ The analysis included Argentina, Colombia and Chile

should be stressed that the makers of macroeconomic policies will have to take due account of sectoral requirements in order to ensure a reasonable and balanced growth of nontradable goods.

To insure that the viewpoints of sectoral and macroeconomic policies be compatible is always a complex undertaking, especially when the economic situation is unusually rigid. In practice, the macroeconomic policy will focus on the shorter term objectives, a policy that aggravates the situation in Latin America which has become more acute in the last few years (as a result of the crisis and the adjustment process). In this context, the priorities that concern agricultural development take second place. In short, there are temporary inconsistencies and contradictions between the priorities of macro policies and those of sectoral policies.

We must try to strike a very reasonable balance between macroeconomic policies and sectoral policies. Excessive emphasis on the ramifications of the RER can lead to similar excessive emphasis on macroeconomic conditions or policies, at the expense of the sectoral ones.

If we accept the premise that in a crisis situation the macroeconomic policy determines economic actions, and consequently everything relating to sectoral policy is subordinate to it, a valid question to ask would be: what to do when stability is restored? Experience, at least in Central America, seems to indicate that even when the domestic crisis is overcome --or a certain internal equilibrium has been reached-- there is a tendency to continue with the same macroeconomic policy objectives and instruments. It could come to pass and seem more logical, that, though the end purpose remain the same, the macroeconomic policy would use those same instruments in a more differentiated and selective, but less global, way. The same could be true of the policy governing net capital flows that affect the RER.

The factors --such as external indebtedness and the resultant fiscal deficit-- that adversely affect the RER warrant more detailed analysis, especially after seeing the effect that the monetary policies and the interest rates caused by macroeconomic determinants have had on agricultural development policies.

If we understand the RER to be an indicator of equilibrium in terms of advantages and disadvantages in the intersectoral allocation of resources from the standpoint of the "economic policy", it is extremely important and never superfluous to examine the distribution effects, primarily between profitability to producers in the sector and real wages. This is even more crucial when the basket of tradables includes wages as one of the goods. For example: if world prices of agricultural and livestock products fall as a result of specific policies in the developed countries, the adjustments that take place must perforce have an impact on the drop in real wages in the agro exporting countries. And, given the constraints on certain current real wage levels, the people in charge of macroeconomic policies will inevitably be forced to take steps to maintain real wages.

At the same time, analysis of the distribution factors in the context of a RER approach requires the areas of property concentration and prevailing income to be taken into account as part of the agricultural sector's structure.

The factors that in one way or another affect the RER include those linked to institutional changes: the effectiveness of institutional systems in making policies operative. Failure to consider these aspects explicitly can lead to a mistaken assessment of the capability or soundness of the policies that are being implemented. In this respect, mention might be made, for instance, of the rigidity of expenditures for goods and personal services in the budgetary structures. This is often the reason why a decline in public spending ends up reducing the levels of investment, thus decreasing the sector's profitability. At the same time, many countries show evidence of rigidity and pressures exerted by institutional mechanisms stemming from the existence of informal markets that in one way or another affect intersectoral profitability.

In evaluating the development of the macroeconomic policies applied in the past, which on many occasions inhibited the performance of the agricultural sector and introduced an anti-export bias, we must not lose sight of the fact that our understanding of the interactions between sectors and of the regime of macroeconomics was much more limited than now. The global scenario of the economic policy was also very different. Having made this statement, a pertinent and immediate task should become apparent: the need for permanent monitoring of what is happening with incentives. This means a continuous audit of the extent of sectoral protection, of the evolution of the RER and the cost-benefit relations stemming therefrom.

As to the subject of income distribution, it can probably be anticipated that if a more neutral policy were applied to agriculture by means of the RER and direct incentives, the effect on the wage earning sector --or as a minimum on the urban one-- would be negative. There is, consequently an obvious need to identify in the short and medium terms compensation mechanisms and subsidies for the more vulnerable groups. Past experience raises many doubts as to the validity and cost of indiscriminate subsidy policies.

The discussion of the topics mentioned above indicated an acceptable level of general consensus, but elicited many questions, thus clearly suggesting that certain areas require further and more detailed analysis.

1. Make the trade-offs that those policies entail more clear and explicit. A particularly relevant one is the trade-off posited between the objective of improving the competitive position of tradables (via the RER) and the situation of impoverished consumers. The relevance of the discussion increases in direct proportion to the degree of importance of the "goods and wages" sector in the structure of agricultural exports.

2. It is important to consider the inherent difficulties of obtaining short and long-term consistency, both in the design of macroeconomic and sectoral policies and in achieving a RER that would send consistent signals as to intersectoral and intrasectoral profitability beyond the short term.
3. It is essential to develop a capacity for accurate perception of macroeconomic relations, especially the effect that macroeconomic policies produce on the technological base: for example, the extent to which commercial inputs are used.
4. Examine the situation of the international trade that influences national prices by means of the price level, and exerts a further indirect effect by means of the macroeconomic variables that influence the agricultural sector (trade balance and exchange rate, external deficit, public finances, and the like).

B. DISCUSSION DOCUMENT

Agricultural Trade and Macroeconomic Policies: Impact on Agricultural Growth in Latin America 1/

Agricultural growth interacts very closely with developments in other sectors of the economy, particularly with trade and macroeconomic policies. Intervention in agricultural markets is widespread and is practiced in Latin America as well as elsewhere in the world. In addition to institutional reform, there are basically two sector-specific policies governments can use to affect agricultural growth. These are government expenditure and incentives policies. The latter include agricultural trade restrictions (import tariffs, export subsidies or taxes, import or export licensing), and minimum and maximum producer and consumer prices.

However, there are other policies directed at the macroeconomic management of the economy (e.g., on nominal exchange rates, government spending, wages, international capital flows, and trade policy for other sectors) which are of crucial importance in the structuring of incentives for agriculture. The consequences of these policies can reinforce or neutralize the policies directed solely at agriculture. Historically, in several Latin American countries, import-substitution-based industrial growth pursued through tariffs and other import restrictions and more recently in the late 1970s, the extraordinary high level of the foreign debt, have created a strong bias against agriculture and resulted in a structure of incentives that could have unfavorable effects on the long-term production growth of agriculture.

The real exchange rate (RER), (defined as the relative price of tradable export to international consumption), has been increasingly recognized as playing a central role in determining the profitability of tradables -- which compete with imports (such as cereals) and exports -- in agriculture, in relation to the domestic goods sector in general, and in relation to the nonagricultural sector. It is in fact through the real exchange rate that the macroeconomic management of the economy affects agriculture. Though impossible to measure with great precision, the distinction between home goods and services and tradable exports becomes crucial, because the value of the latter are exogenously determined by foreign prices, by the nominal exchange rate and by trade policy. In contrast, transactions in domestic goods are cleared internally, and could be influenced indirectly by macroeconomic and trade policies.

1/ The original document was prepared in English by Economist Alberto Valdes (Interamerican Food Policy Research Institute -IFPRI-) for the World Bank Institute for Economic Development. It does not necessarily reflect the opinions nor the official policies of the World Bank or of the Interamerican Institute for Cooperation on Agriculture.

The tradable component in agriculture is larger than in the rest of the economy. For example, tradables represent more than two-thirds of the sector's economy in Argentina, Colombia, and Chile. In contrast, the nonagricultural sectors in most countries are characterized by a much larger proportion of nontradables. In Colombia, it is estimated that over 50 percent of nonagricultural production is derived from nontradables such as commerce, public services, transportation, construction and housing, and banking 1/.

Sustained overall sectoral growth implies resource flows between sectors, such as labor and capital, which adjust to their own relative opportunities. Thus, in analyzing the long run effects of incentives on production and growth, we should have a panoramic view of the returns of these factors on the economy as a whole. The real exchange rate approach is applied precisely because of its relevance for studying such inter- and intra-sectoral resource movements as may result from trade and macroeconomic policies.

Although one is becoming increasingly aware of the importance of the macroeconomic setting to agricultural performance, so far this setting has remained outside the scope of an appropriate strategy for agricultural development.

Since the late 1970s and early 1980s, Latin American countries have faced complex issues of adjustment and growth. The difficulties have been attributed to both the international economic environment and domestic economic policies. While international economic conditions -- such as lower export prices for several products and higher real interest rates in the early 1980s -- are crucial to understanding the current economic, this presentation emphasizes domestic economic policies. It has been argued that the domestic economic climate, has as a rule no been adequate for the stimulation of agricultural growth in Latin America. Other sessions in this Conference address issues related to the external environment.

The current difficult external and macroeconomic conditions may offer an opportunity for revitalizing the agricultural sector in Latin America. A better understanding of the nature of this process is needed, however. Expansion of production of "tradables" -- both export diversification and expansion, and import-competing activities -- constitute perhaps the principal structural change that many countries in the region need to make. The success of such a change could depend on agricultural growth. Rather than relying on highly selective schemes of export subsidies or quotas and high tariffs on imports, it is submitted here that correct real exchange rate alignment and an established stability in RER policy (stability of the policy, not necessarily of

1/ García, Jorge, and Montes, Gabriel, "Coffee Boom, Government Expenditure, and Relative Prices in Agriculture: The Colombian Experience". (IFPRI Research Report forthcoming).

the RER), is in many countries the most crucial price variable for taking advantage of the growth opportunities offered by international trade to agriculture in Latin America.

For an analysis at the sectoral level, it is useful to compare the effects of what can be called a "direct price" intervention, resulting from explicit agricultural policies (including trade policies), in relation to the effect of "indirect" or economy-wide policies affecting the sector's relative prices.

In Argentina between 1960 and 1984, both agricultural and economy-wide policies have taxed production of wheat, beef, and corn as shown by Figure 1. This could be anticipated given the existence of an explicit export tax on agricultural exports (which was highest during years of high world prices, such as 1974-75). Direct price interventions reduced the domestic price between 12 and 42 percent for wheat, and between 11 and 35 percent for beef. Economy-wide indirect interventions added a substantial amount to the total taxation imposed on these goods: for example, during the period 1981-1984, the effect of economy-wide price interventions added 29.2 and 39.5 percent to the total tax on wheat and beef, respectively, over and above the direct (sectoral) taxation of 17.3 and 13.8 percent. Of course, the reverse -- that is, a subsidy-- occurs with respect to domestic consumers in Argentina. As a result of direct taxation to exports, and aside from other possible price interventions applied at actual levels, prices to domestic consumers during 1960-84 were subsidized between 12 and 42 percent for wheat, and 11 and 35 percent for beef. Fiscal revenue objectives and cheap food policy for urban consumers were undoubtedly very strong economic and political forces behind the taxation of agricultural exports in Argentina.

The situation in Chile indicates a relatively stronger effect of economy-wide policies on incentives to farmers. Except for beef production, which was subject to both direct and indirect taxation throughout this period, wheat growers received slightly positive nominal protection (except during 1971-75, a period coinciding with two years of high world prices), and dairy farmers received a very substantial level of nominal protection during the entire period. Economy-wide intervention substantially reduced the net level of protection to milk production (with a net effect of taxation in 1971-1975), nonetheless the levels of overall protection for that sector were around 25.3 to 93.0 percent for the period 1960-1980. On the contrary, the slightly positive direct protection for wheat is invalidated by substantial indirect taxation, resulting in the overall taxation for the period 1960-1975. Positive total protection of 20.8 percent prevailed in 1976-1980. For beef production, economy-wide interventions add between 25 and 41 percent between 1960 and 1975, yet had practically no effect during the period 1976-1980.

In Colombia, coffee producers have been taxed consistently throughout the 1960-83 period (Figure 1c). However, there is a real question of how much of this export tax was applied to improve world coffee prices, as part of an international commodity agreement between large coffee exporters. Wheat and cotton in Colombia present the opposite case --that of an import-competing

activity, and an exportable one --with substantial nominal protection for wheat production (except in 1971-75) and lower protection for cotton. Adjustment for economy-wide interventions reduces substantially the real protection for wheat and cotton production (Figure 1c). In fact, it becomes a total negative protection for wheat between 1971-80, and negative protection for cotton, except during 1966-1970.

As can be observed in these three countries, the effect on relative prices for agriculture attributable to economy-wide policies has been, in most cases, equivalent to, or sometimes larger than, the effect of sector-specific (direct) price policies. This measured economy-wide effect represents in essence the impact on the RER of the trade, fiscal, and monetary policies followed during this period.

Concluding Comments

The effects of policies directed at the macroeconomic management of the economy on agriculture can more than offset the sector-specific policies, in terms of its incidence on the relative price signals guiding producers and consumers. This may have an influence more specifically on agricultural tradables for exports. Observations from several South American countries, as well as in the Philippines, Nigeria, and others, show that agricultural tradables are usually discouraged, whether they are import-competing commodities or exportables. This penalty imposed on agriculture is inherent and will last as long as industry is highly protected; it could however also apply following a heavy influx of capital.

It is postulated that in LDCs most agricultural products are tradables. But domestic consumer goods are important as sources of traditional food products, particularly in sub-Saharan Africa, rather less in Latin America. The empirical evidence, taken from several studies at IFPRI, indicates that producers of domestic goods can benefit indirectly from industrial and exchange rate policies, if the prices of these domestic goods increase in relation to tradables. However, the possibility that foods for home consumption (such as legumes, root crops, etc.), and tradable foods (such as cereals, oilseeds, milk, etc.) can be substituted one for the other in local consumption, puts a ceiling on the market prices of the home goods. This ceiling is determined by the effects of the foreign trade and exchange rate policies on the prices of the tradables. Furthermore, it is likely that foreign trade regimes in many LDCs contributed considerably to their growing dependence on imported food, by taxing production and explicitly subsidizing consumption of tradables.

The disappointment shown in much of the current literature with the performance of agriculture in LDCs is centered on the production of tradables. It is usually associated with poor export performance and the growing need for

foreign exchange for food imports. However, the risk involved in adoptery a trade-oriented policy for agriculture, is often cited as grounds for rejecting it 1/.

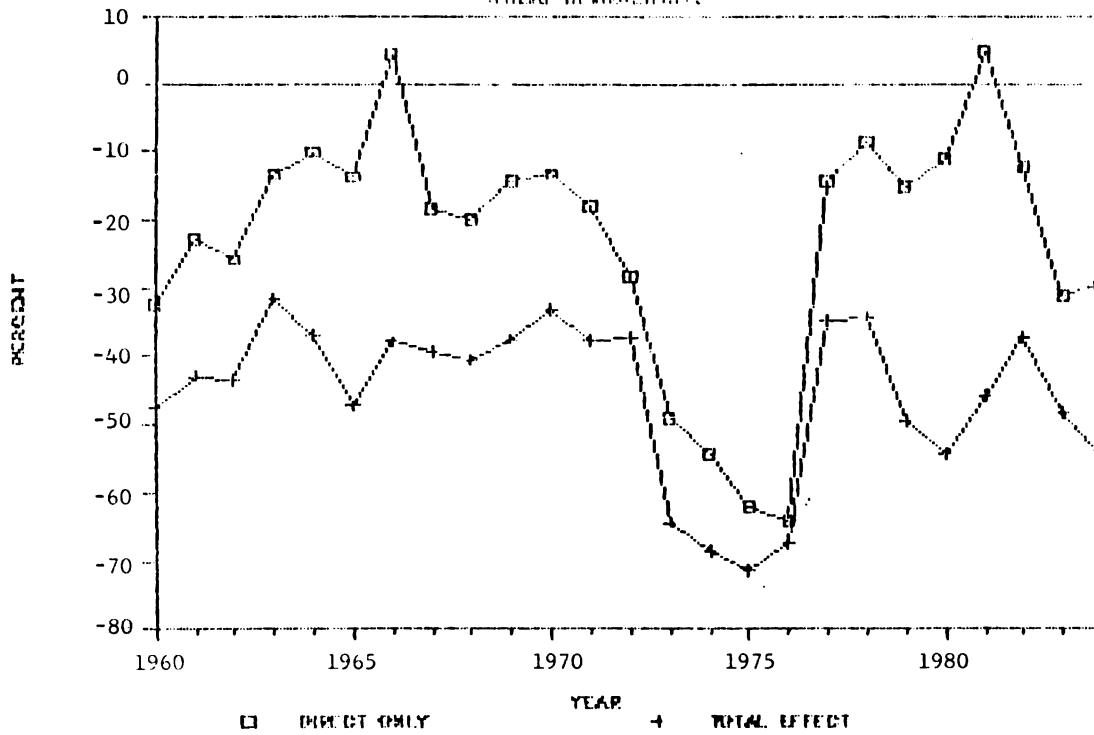
This is essentially the risk as perceived by governments, with their own concerns about world price-related risks, fluctuations of government revenues, and food security. As a result of these concerns, some governments have followed a variety of risk reduction policies. A warning is needed in a environment in which the production of agricultural tradables has been taxed rather heavily in many LDCs, usually implicitly and unintentionally. Policies that send to "close" the economy could put a damper on the very subsector that has the highest potential growth.

1/ Valdés, Alberto; Siamwalla, Ammar. "Foreign Trade Regime, Exchange Rate Policy, and the Structure of Incentives for Agriculture: Issue and Policies", presented at IFPRI's Agricultural Price Policy Workshop held in Elkridge, Maryland April 29 - May 2, 1984.

Figure 1a: ARGENTINA

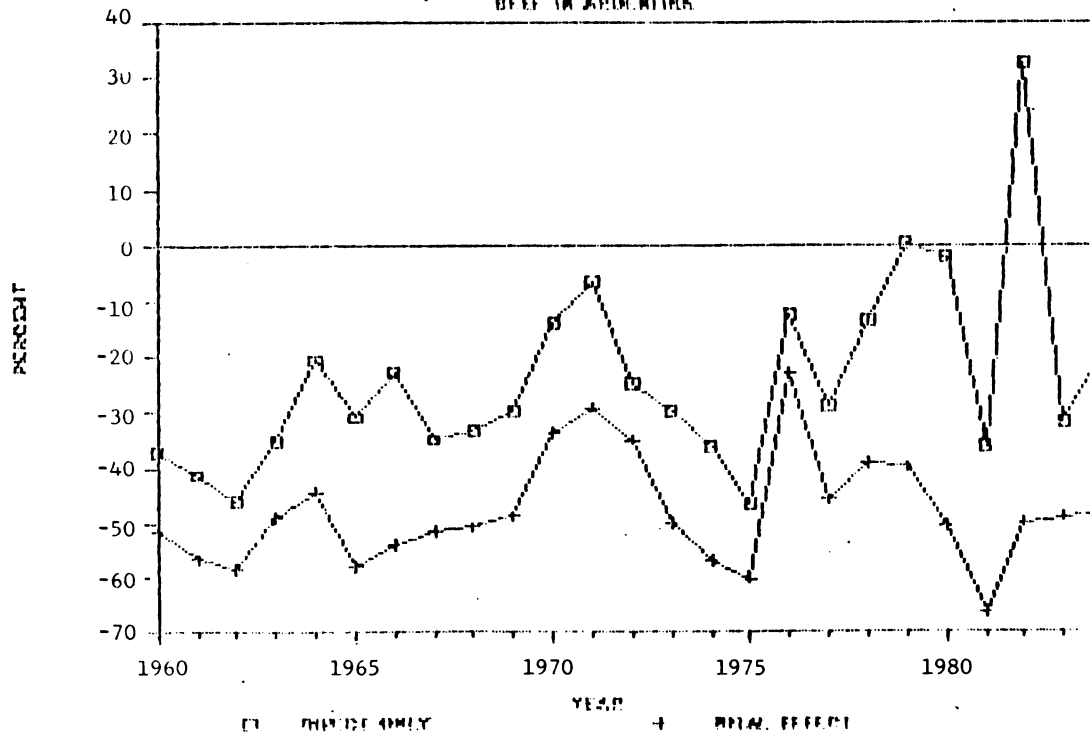
DIRECT AND INDIRECT INTERVENTIONS--

WHEAT IN ARGENTINA



DIRECT AND INDIRECT INTERVENTIONS--

BEEF IN ARGENTINA



DIRECT AND INDIRECT INTERVENTIONS

CORN IN ARGENTINA

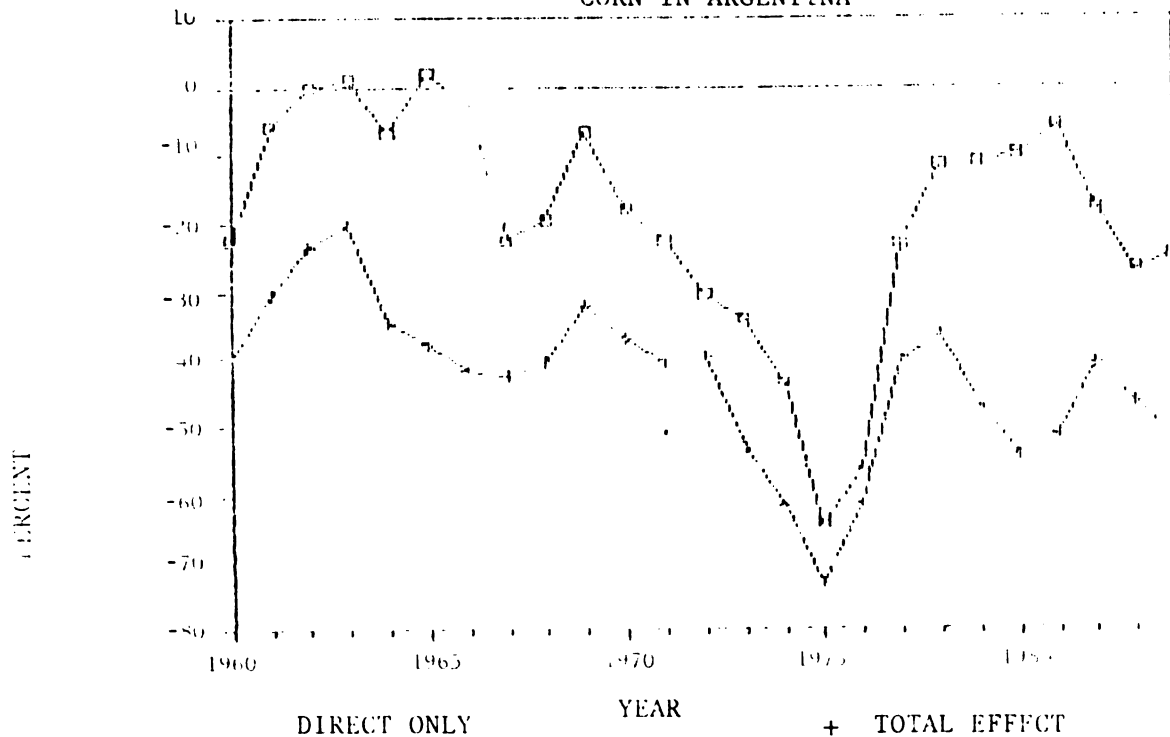
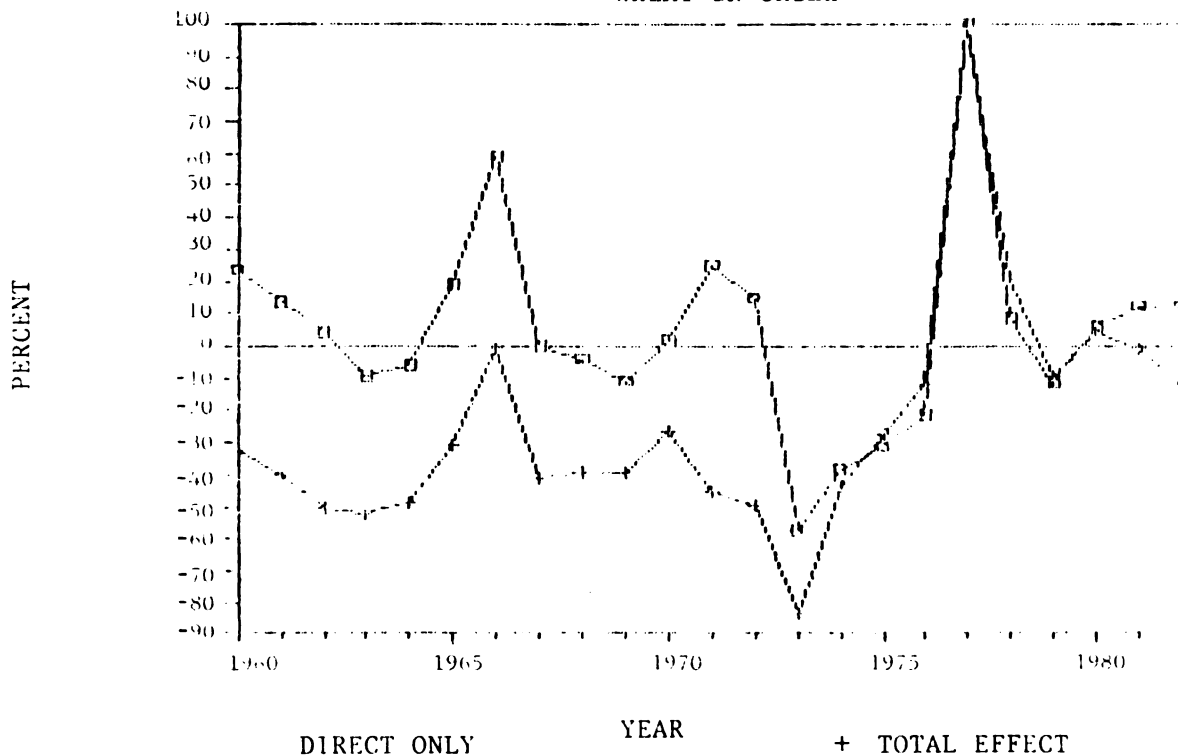


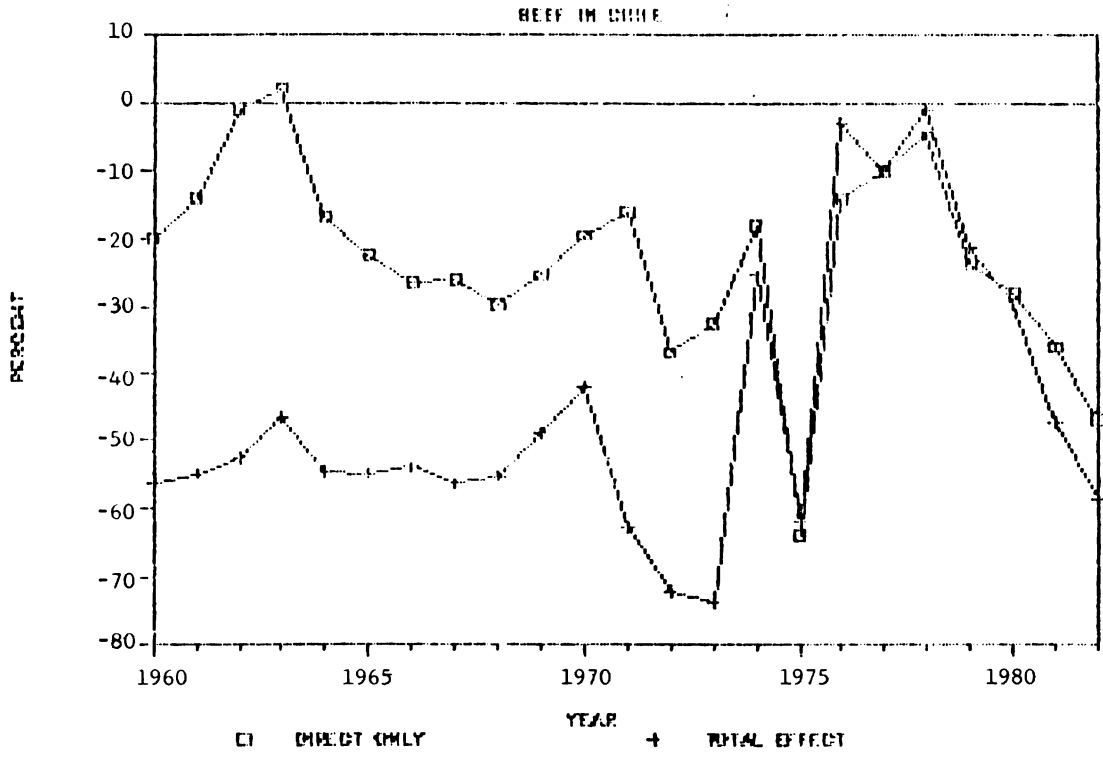
Figure 1b: CHILE

DIRECT AND INDIRECT INTERVENTIONS

WHEAT IN CHILE



DIRECT AND INDIRECT INTERVENTIONS---



DIRECT AND INDIRECT INTERVENTIONS---

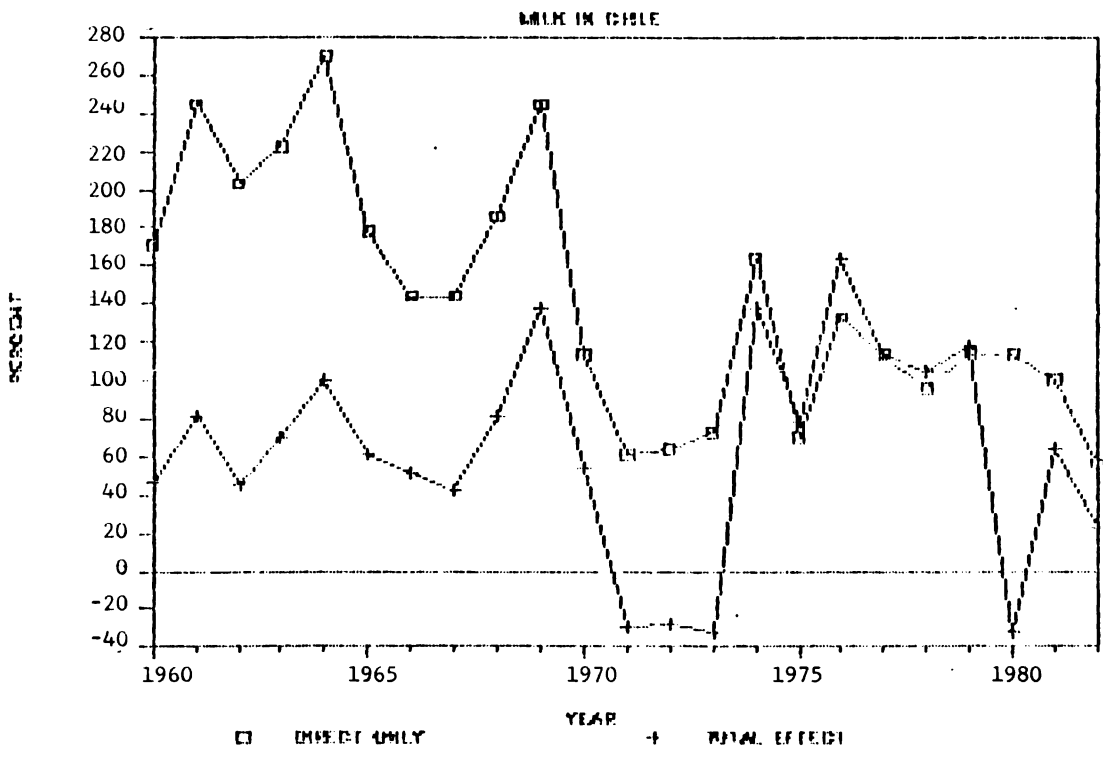
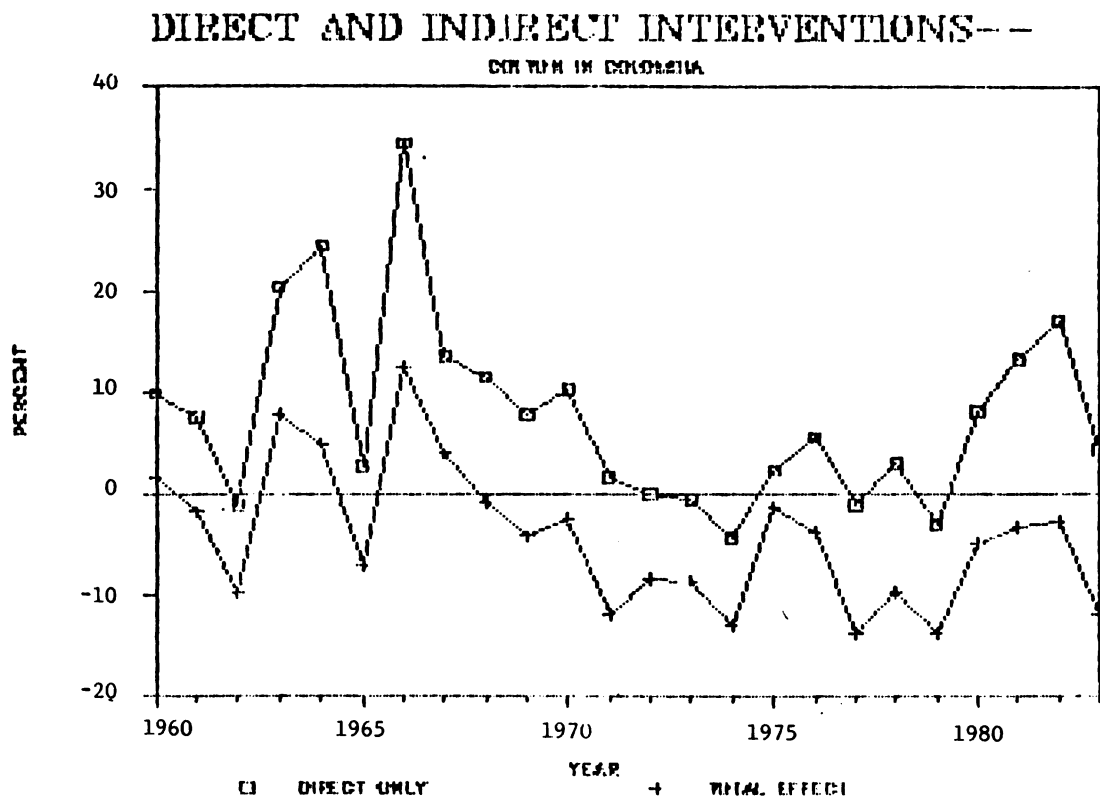
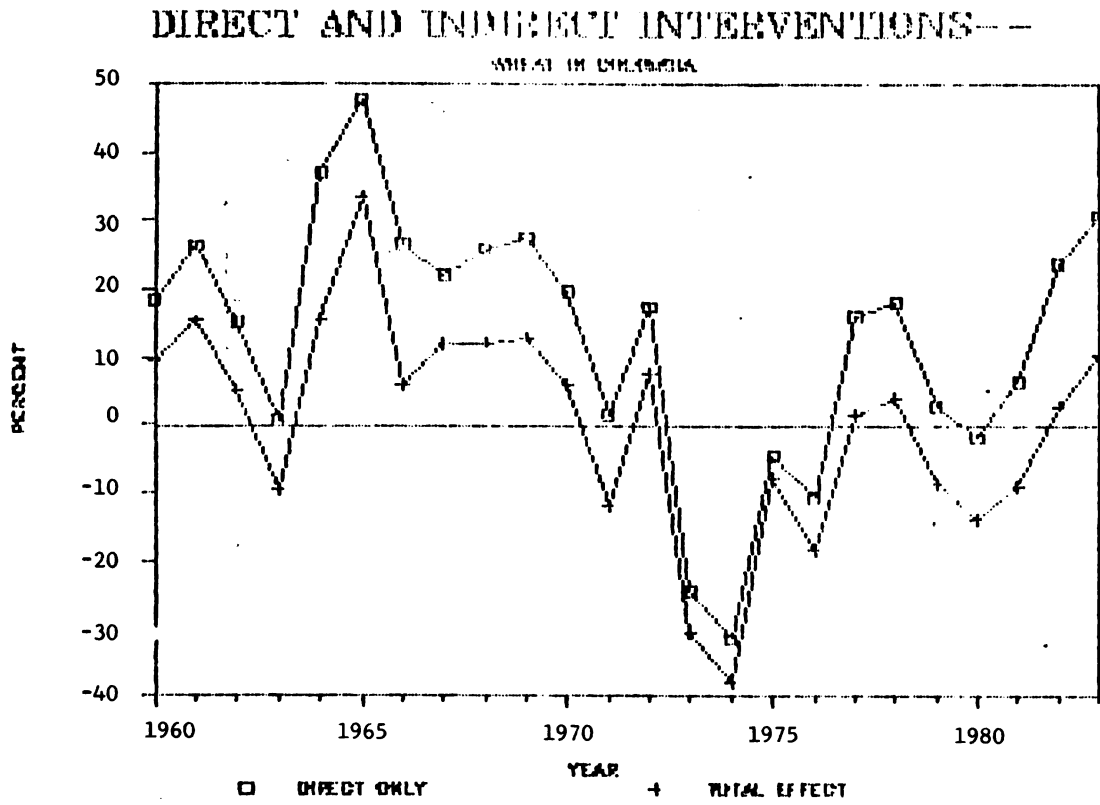
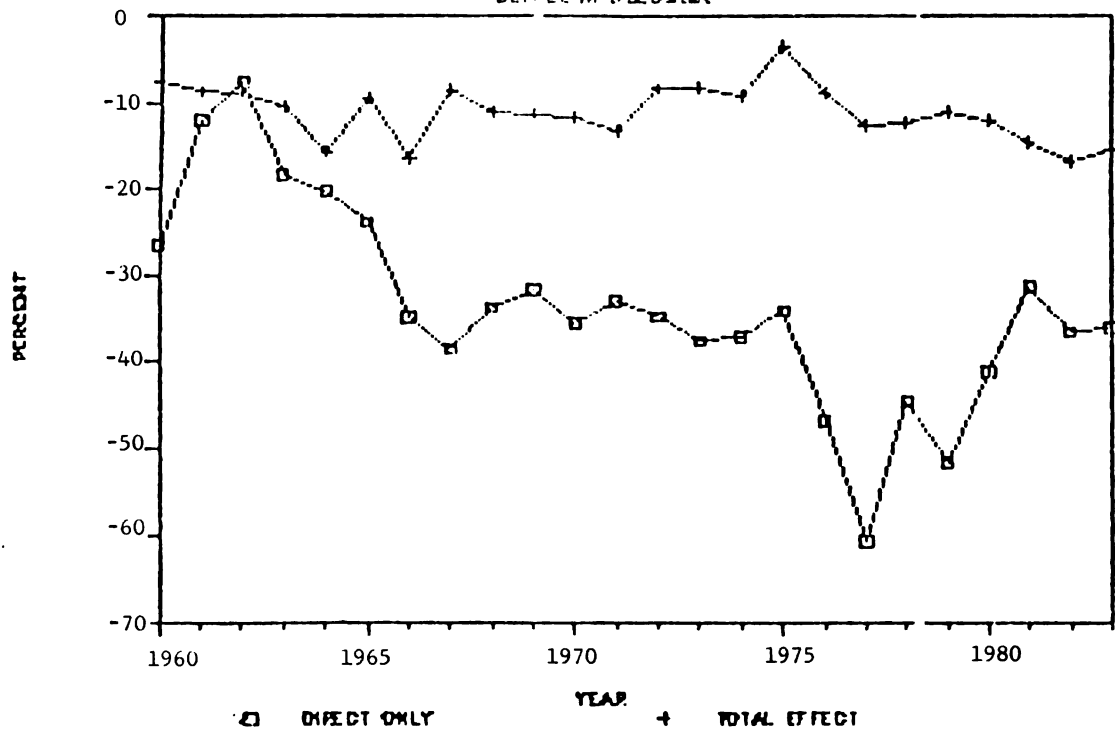


Figure 1c: COLOMBIA



DIRECT AND INDIRECT INTERVENTIONS--

COFFEE IN COLOMBIA



IX. INTERNATIONAL ECONOMIC CONDITIONS FOR AGRICULTURAL TRADE: PRESENT STATUS

A. SUMMARY

Presentation

For the first time in the history of GATT negotiations, there is a desire to include explicit treatment of agricultural commodities. In the earlier rounds (Dillon, Kennedy, Tokyo), agriculture was practically omitted from the negotiations.

If the intentions expressed in conjunction with the Uruguay Round bear fruit, Latin America could reap many benefits. In this context, it is very important to identify the items of interest that arise in the GATT negotiations and also to determine what Latin America's priorities should be.

Insofar as protection is concerned, agriculture --unlike industry-- is a highly protected sector in the northern hemisphere countries and in all members of the OECD. It should nevertheless be noted that trade policies in the European Economic Community, the United States of America and Japan are reflections of national income policies, and therefore not trade policies per se.

In the underdeveloped countries on the other hand, agriculture has become relatively well developed and the industrial sector is highly protected. In contrast with the developed countries, protection is implicit and derives from policies, that are not exclusively those of the agricultural sector.

Many of the tropical commodities now operate under GATT regulations. By contrast, those from temperate and subtropical climates have for the most part been outside the scope of GATT, because both the Economic Community and the United States have insisted that their national policies should not be subject to scrutiny by the international agencies, and that policies concerning their agricultural sector are essentially concerned with farm income no with trade, and therefore not subject to negotiations.

The escalation of agricultural protection in recent years is highly significant. For example, the cost of subsidies to the United States in 1980 was US\$25 billion. That of the European Economic Community rose from US\$6 billion ten years ago to approximately US\$22 billion per annum at present. Another problem for GATT negotiations is the plethora and diversity of the mechanisms used to impose these protectionist policies.

In North-South dealings, negotiations concerning agricultural trade are the key economic relationships. Because South-Southern trade is still limited, 65% of the farm exports from the developing countries go to the OECD. There can be no doubt that the decisions adopted by the European Economic Community, the United States and Japan will be of great importance for the improvement of the

international terms of trade for agricultural products. The Latin American countries, taken individually, have very little influence, and they lack a unified representation within GATT --which, however is the only option available to the developing countries for upgrading their bargaining power.

It is important to include measures in negotiations that transcend the confines of national borders or trade policies. One of the many difficulties is identification of exactly what constitutes protectionist measures. In the past, GATT concentrated on tariff barriers in agriculture. Lately, however, many of the developments in agricultural protectionism have resulted from non-tariff measures, despite the fact that most GATT regulations are not designed to cope with such strategies.

Non-tariff measures (for example, restrictions on a quantitative bases, purchases by government agencies, sanitary regulations, animal health regulations, customs evaluations, nomenclature problems, and voluntary restrictions on exports) are much less visible and much more difficult to quantify. All such non-tariff regulations virtually nullify current GATT rules; they are unmeasurable and unlimited. An additional problem that arises from these non-tariff regulations is the difficulty of speaking of reciprocity in a strict sense, for it is not easy to set a value on the flows of trade that might be generated by changes in non-tariff measures. An added difficulty in these negotiations is how to measure the incidence of, for instance, the changes in macroeconomic policy that affect exchange rates -- variations that can even, albeit temporarily, neutralize the impact of direct subsidies.

Any attempt to quantify the effect of agricultural protection on international trade flows of farm products must recognize three aspects: 1) a direct effect which can be translated by: the greater the protection, the more international prices will tend to fall; 2) the form of protection in some cases greatly increases the instability of international prices: such is the case with the variable levies applied by the European Common Market, which affect the variation coefficient of international prices; and 3) an indirect effect and a usually very important one: the fact that protection is so unilateral and unpredictable means that the rules of trade may change at any time, giving rise to deep pessimism in regard to exports.

Despite the countless difficulties of measuring the effects of protection and the way they are distributed, various estimates have been produced. In the case of raw materials that do not compete with OECD countries, on which protection is therefore low (rubber, jute, cotton), the changes in international prices resulting from greater liberalization are not very significant. However; in commodities such as sugar, beef, and semiprocessed products the change in the international price is much sharper, and the increase triggered in the agricultural market by heightened liberalization would accrue to the developing countries, particularly to those of Latin America.

There are other products, such as lamb, pork, and wheat, in which any increase in trade would benefit the developed countries.

A subject of concern is that the poorest countries are the ones least benefited by liberalized trade in farm commodities. This is the case of certain African countries and parts of Asia that produce tropical products having little protection, countries that are furthermore net importers of cereals and dairy products.

Assuredly the impact of liberalization is as unevenly distributed between the poor and middle income countries as among the continents. Hence it will not be easy to establish a common front with the African countries south of the Sahara or with different countries in Asia.

The case of cereals is the most delicate: for many developing countries, protection of this commodity is a benefit since it represents a transfer of income from the developed countries that export grain. Obviously, the protection is detrimental to grain producers of the developed countries, since subsidized exports depress prices.

In the studies that have quantified the benefits of greater liberalization of farm commodities, two aspects were not measured: 1) the effects triggered in trade and production if the changes made by the European Economic Community, the United States and Japan are to be significant, permanent and radical; and 2) the reduced instability of international prices, which has to do not with the level of protection but with the system used for protection (national stabilization and stock policies), whereby the countries of the European Economic Community transfer their instability to the international market.

In the light of this general background, it is interesting to ask oneself what Latin America's policy in future negotiations with the GATT should be. Three factors may be underlined in this respect: 1) actions designed to provide greater access to markets; 2) GATT rules and disciplines; and 3) the introduction of "reciprocity" in the negotiations.

Access to markets : The OECD countries are the cause of most of the tremendous distortion observed in international prices of farm products. From a negotiating standpoint, the main issues are the levels of protection and the gap between domestic and international prices. Emphasis should be placed on discussing the levels --rather than the techniques-- of protection, given the non-tariff measures designed to keep imports out of OECD domestic markets. In other words, in the Uruguay Round, Latin America does not need to stress tariff measures, which are among the least important factors in agriculture, except for semiprocessed goods for which tariff schedules exist.

Accordingly, the best suggestion is to focus negotiations on protective measures and nominal rates, to try to maintain present dispositions and to reduce as much as possible existing protective measures.

GATT rules and disciplines: The current exceptions to GATT rules on agricultural commodities (safeguards and quantitative restrictions) are very dangerous, for they could be applied unilaterally to any given country at any

time. Defense mechanisms have proved to be inadequate, as for instance the "dispute panels" in which there are no means of imposing a change and therefore decisions which must be reached by consensus take the form of mere recommendations. Greater transparency should be sought and the recommendations should be published, even if a consensus is not forthcoming.

Reciprocity: Given the limited influence of the Latin American countries, considered individually, the negotiating positions they adopt should offer some incentive to the developed countries. This is tantamount to accepting reciprocity in a broad sense, for instance, by allowing a small opening in the highly closed and protectionist industrial policy. Reciprocity in the broad sense should be essentially intersectoral. Those wishing to maintain the "status quo" will insist on negotiating, sector by sector, such is presumably the position that will be taken by the European Economic Community.

Preferential treatments, if kept in effect, may have a very high opportunity cost in terms of concessions, distracting attention from other type of negotiations that are far more important to the underdeveloped countries. If this is found to be true Latin America will be compelled to seek more equal treatment within the GATT: a more symmetrical reciprocity. In this context, negotiating power would reside in the ability to offer incentives that induce the other parties to make concessions, or to at least be willing to consider their possibility.

The emergence of other options or modalities for negotiation, such as those proposed by the CAIRNS Group, seems very promising and attractive, representing as they do an attempt to highlight negotiations that will have real impact on the opening of markets. This is in essence a policy of negotiation...not confrontation.

Comments

It was emphasized that protection in the Northern block countries has increased radically, having surpassed record levels of the 30s. Countries that had postulated self-supply policies in the beginning, have wound up as exporters.

World Bank estimates of greater liberalization of agricultural products indicate a gain of US\$50,000 million for the developed countries and US20,000 million for the developing ones.

At this session, emphasis was placed on the need for trade reform, replacing quotas with tariffs, and reducing the levels of the latter to make them more uniform. It should be remembered however that the aim is to improve the real terms of trade, by means of a neutral economic policy that would provide evenhanded treatment for agriculture and industry.

The great difficulties faced by the developing countries --such as the challenge of selling similar products in similar markets, among other predicaments-- must also be kept in mind. Markets today are glutted and the

resultant trade dilemmas stem very largely from lack of growth. Another serious problem in the short term is the existence of large stocks in the United States and in the European Economic Community, and prospects for many commodities suggest that prices will continue to fall. In the long run, this will have a dampening effect on investments.

A further predicament is the result of a change in consumer habits. Enormous pressure is evident in the use of health considerations as an excuse for some consumer shifts (e.g., from red meat to white). This should be taken into account when the time comes to negotiate.

It should also be remembered that world recession tends to establish a new type of protectionism that differs from the traditional system based on tariff measures. (Reference was again made to the difficulties inherent in the efficacy of nontariff measures, which are not easily quantifiable).

Furthermore, the developed countries carry out policies sponsoring import substitution by means of subsidies to "research and development", all the while claiming that the developing countries should not engage in any such substitution because of the opportunity cost.

In assessing the performance of the international farm commodity market, one must not lose sight of the possibilities offered by intra-regional trade. By the same token, Latin America's capacity to negotiate bilateral agreements must be recognized and emphasis must be placed on improving the design of development policies, seeking to strike a balance between the possibilities implicit in a selective policy of import substitution and exports to the international market.

The income-producing nature of the policies followed in the agricultural sector by the countries of the Northern hemisphere was highlighted, and it was felt that they could be clearly identified as direct transfers of income in order to eliminate all subsidies, either in the form of prices or direct support to production.

It would seem that to emphasize the apparent contradiction between products of countries in temperate zones and of those in the tropics would be unadvisable. On the contrary common positions should be adopted in order to revise domestic policies governing the supply and production.

Insofar as the reciprocity factor is concerned, it was emphasized that so long as the imbalance between developed and developing countries persists, the very essence of reciprocity may continue to be questioned, since it requires a certain degree of "equality" between parties.

As to the relatively more limited power of the developing countries in the cause of GATT negotiations, the value of a bargaining strategy that would allow defense mechanisms to be strengthened should not be underestimated. This could result, for example, from implementation of a system of fluctuating tariffs designed to protect the national market. Although in the short term,

this would have a destabilizing effect on the international scenario, it would boost the negotiating power of the developing countries in the medium and long terms. It would also minimize the effect of the instability that poses a threat to the sector's investment level (fluctuating tariffs to protect the national market).

The speaker emphasized that trade conditions for farm commodities depend to a large extent on the internal political situations of the different markets. Accordingly, the analysis of the international trade structure for agricultural products seems to reveal extensive lack of knowledge of political economy structure, even on the part of the very countries that comprise this scenario.

A forum should be held on the intrinsic factors governing formation of the agricultural policy and the political economy of agriculture, recognizing them as the political forces that generate both national and international policy guidelines. These aspects are vital, but they tend to be overlooked when the discussion centers on academic and quantitative factors.

There are very concrete realities in certain countries that compel them to attach great importance to bilateral negotiations. A case in point is that of the Caribbean Basin countries and Mexico with respect to the United States.

B. DISCUSSION DOCUMENT

Prospects for agricultural trade and prices 1/

In the absence of a recession, the rapid decline in the prices for most agricultural commodities since the highs reached in the mid-1970s appears to be over. The World Bank's weighted index of agricultural prices has declined 52% in real terms since 1974. Certain commodity groups have experienced even more rapid price declines over this period. Cereals, for example, have declined 76% since their 1974 highs and beverages have declined 62% since their highs reached in 1977. An increase in real agricultural prices is projected to occur, beginning in 1987 or 1988 and to continue through the mid-1990s. By 1995 this increase is projected to raise the weighted index of agricultural prices by 20% from current levels. While this is a significant increase, prices in real terms would still not have returned to the 1985 level. A sustained period of rapidly rising real prices seems unlikely because of the combination of surplus production capacity and projected moderate economic growth.

The growth of agricultural trade has slowed dramatically during the 1980s compared to the 1970s. During the period 1969-71 to 1979-81, world agricultural export volumes increased nearly 4% per annum, while in the 1979-81 to 1984-86 period they grew at only 1.3% per annum. The rapid growth during the 1970s and the slow growth during the early 1980s can largely be traced to income growth in the developing countries and centrally planned economies. The lingering effects of the severe world recession of the early 1980s has been a major contributor to the slow growth of exports in recent years. An increase in export growth is expected for the remainder of the decade but exports are not expected to grow as rapidly as during the 1970s. A growth rate of 2.8% per annum is projected for the 1984-86 to 2000 period.

1/ The original document was prepared in English by Economist Donald O. Mitchell (The World Bank Department of Analysis and Economic Projections) It does not necessarily reflect the opinions or official policies of the World Bank or of the Interamerican Institute for Cooperation on Agriculture.

Macroeconomic forecast

Growth of income, changes in the rate of inflation and in the exchange rates between the currencies of major trading countries are critically important factors for the future prospects for agricultural trade and prices. The outlook for the world economy over the next several years is for continued moderate income growth, low inflation in terms of local currencies and a slight decline in real dollar interest rates. Some further decline in the value of the US dollar is also expected, but at a rate slower than for 1986.

The developing countries are projected to have real GDP growth of 4.8% p.a. during 1986-95, compared with 3.3% p.a. during 1980-86. Industrial countries are projected to grow at 3.2-3.3% during the balance of the century compared to 2.3-2.8% during the 1970s. The centrally planned economies are projected to grow at 2.1-2.3% compared to 2.6% in the USSR and 1.8% in other East European countries during 1980-86.

Inflation, as measured by the US GNP deflator, is projected to average 4.6% p.a. during the balance of the decade and 4.0% during the 1990s. US short term interest rates are projected to continue declining during the 1980s and then stabilize at 7.0% p.a. during the 1990s. Real interest rates are projected to fall to 3% p.a. during the 1990s. The value of the US dollar is projected to fall 4.5% p.a. during the remainder of the 1980s, and then recover somewhat in the 1990s. Overall, the macroeconomic forecast is a positive sign for commodity markets and this should contribute to the general price rise expected for agricultural exports and prices.

Government policy

The revisions to US farm policy which took effect in 1986 had important influences on commodity prices --especially for grains, soybeans and cotton. The revisions, which were part of the 1985 Food Security Act, were primarily designed to lower US support prices in order to stimulate exports. The expected increase in exports has not occurred to date and the United States is currently burdened with an expensive farm support program. The effect on the world markets has been to lower prices for all exporters of the programmed commodities. The 1985 farm bill pressured export markets even further by targeting certain export markets for government-assisted price discounts. This program, referred to as the EEP (export enhancement program) was generally matched by increased export subsidies from the European Economic (EEC) in a battle to gain market shares. The consequence of these actions by the United States and the EEC has been to drive prices for certain commodities such as wheat to record lows.

Forecasts

Grain prices are expected to rise from current levels in reaction to a combination of US supply-control measures and producer response to low prices which should reduce future supplies and allow stock levels to fall. However, stocks remain very large and this precludes a sustained price increase in the

near term. The prospects for an increase in wheat and rice prices are greater than for maize because of the current stock levels.

Oilseed prices are closely tied to grain prices because of the dominance of US farm policy on US soybean and maize supplies. Consequently, oilseed prices are expected to reach their lows in the 1986-88 period and then increase during the 1989-95 period. By 1995, real prices are projected to increase nearly 40% from current levels, however, this would still be below 1985 levels.

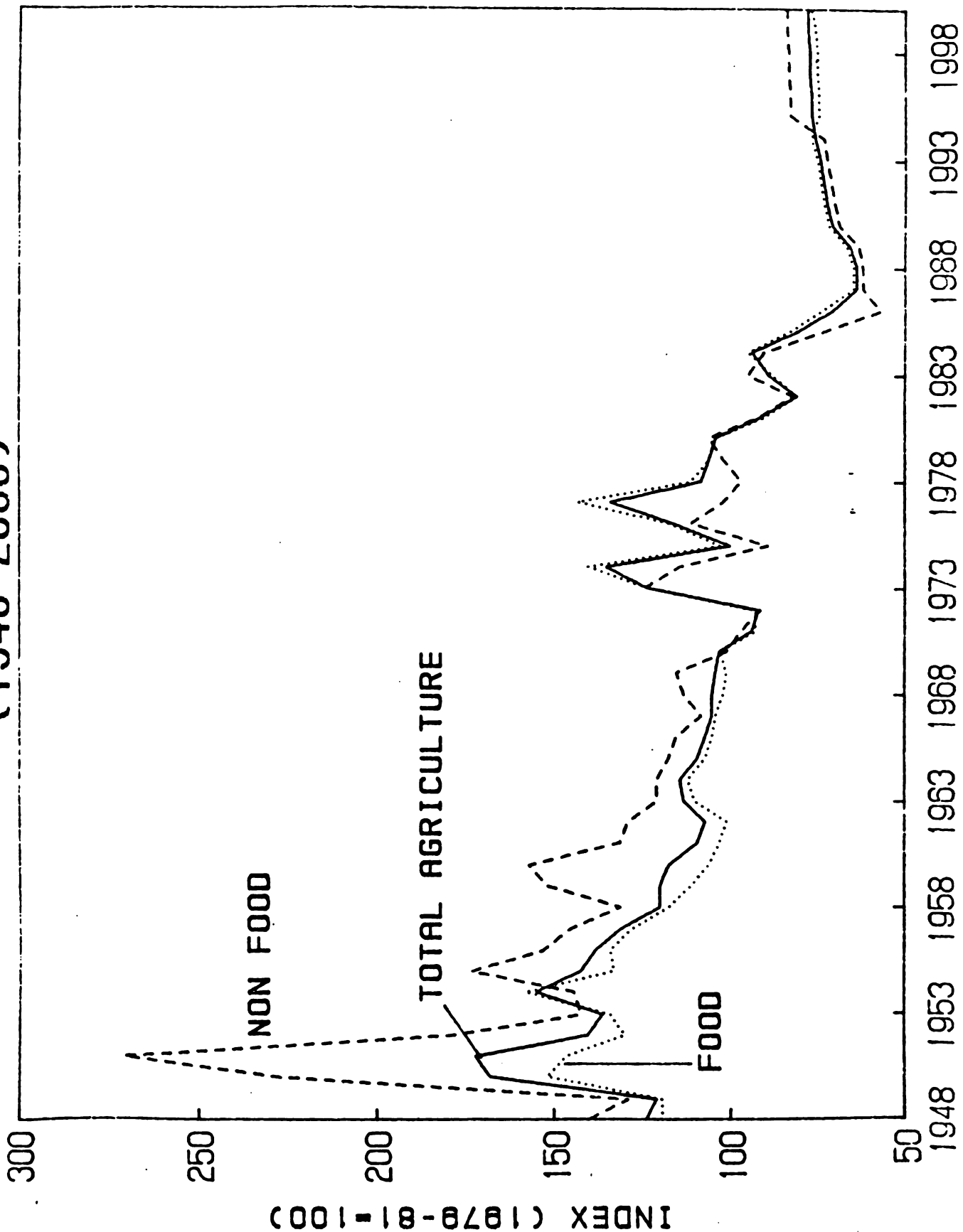
Sugar prices will remain split between the quota and non-quota market with non-quota prices staging a slow recovery. The recent action by the United States in reducing the US import quota by 41% for 1987 will slow the rise in the free-market price. As long as the United States and the EEC interventions remain, free-market sugar prices are expected to remain below the average cost of production except for the occasional year when prices surge.

Beef prices are expected to remain near their present low levels over the near term because of oversupply --particularly in the EEC. By 1989, prices should begin to rise slowly in real terms because of demand growth in the developing countries. Current low feedgrain prices should keep production costs and prices low in the North American market. Downward price pressure is also expected from the EEC's beef reduction program aimed at reducing the existing 600,000 tons beef stockpile to about 300,000 tons by the end of 1987.

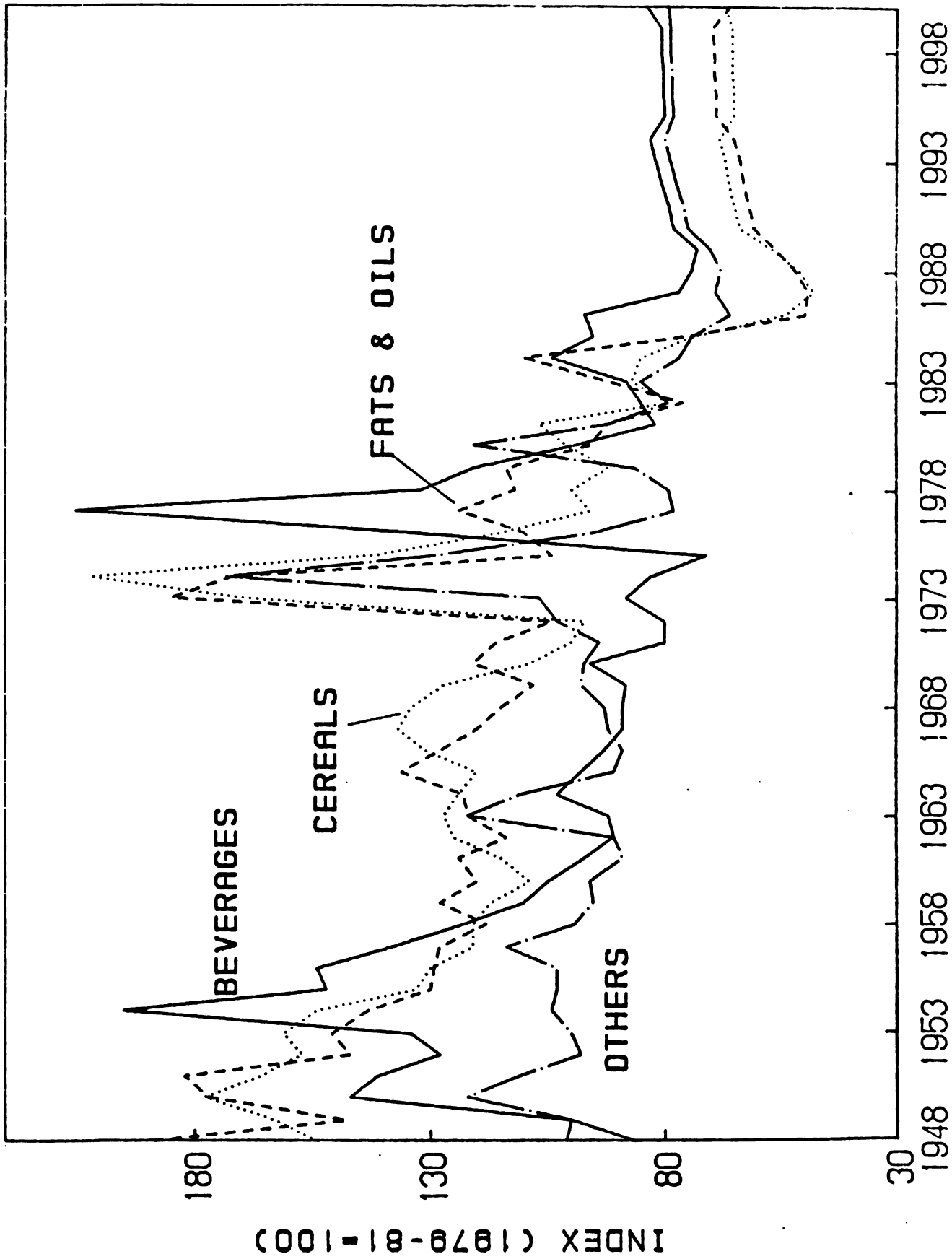
Cotton prices are expected to hold the recent increases due to strong demand growth and deteriorating yield prospects in the northern hemisphere and smaller plantings in the southern hemisphere. The significant reductions in cotton stocks which are taking place in China and the United States, the two countries holding the largest inventories in excess of current requirements, will also bolster market prospects. Prices are expected to remain near current levels for the next three years and then increase in real terms through 1995.

Coffee prices are highly dependent on the future operations of the International Coffee Agreement (ICA). Export quotas agreed to under the ICA are currently suspended, as a result of the high prices due to the drought in Brazil. It is likely that there could be considerable difficulty agreeing on the size and allocation of the quotas. The result of some producers arguing for larger quotas on one hand and some consumers pressuring for a lower floor price is expected to be a larger global quota and a lower floor price in real terms. Consequently, in the absence of major supply disturbances, price prospects are for a continuation of current price levels for the next decade.

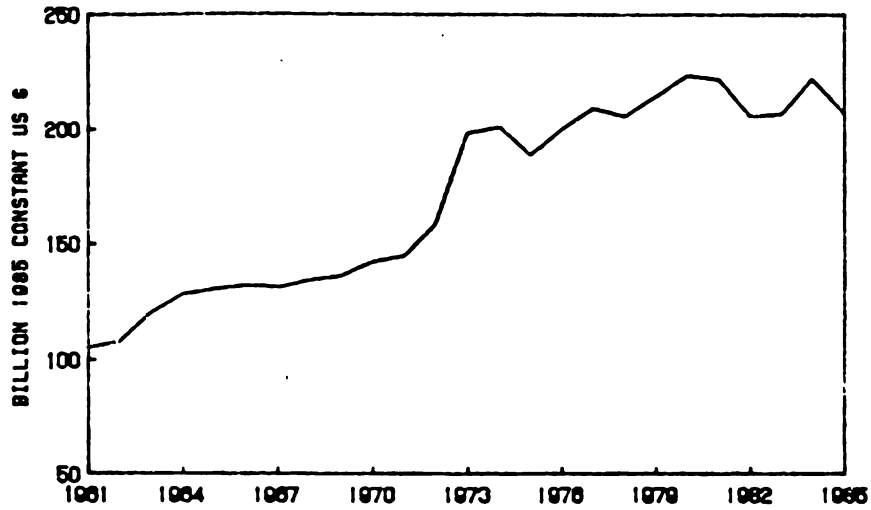
WEIGHTED INDEX OF AGRICULTURAL COMMODITY PRICES (1948-2000)



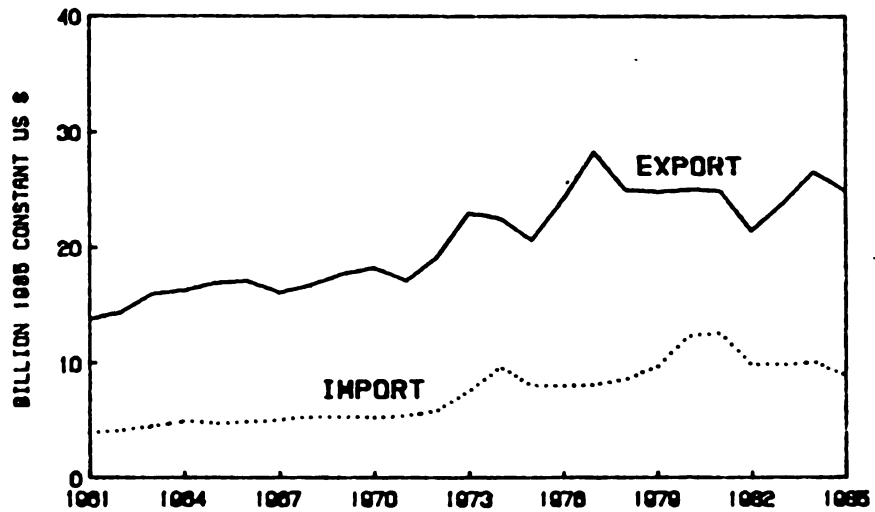
WEIGHTED INDEX OF FOOD COMMODITY PRICES (1948-2000)



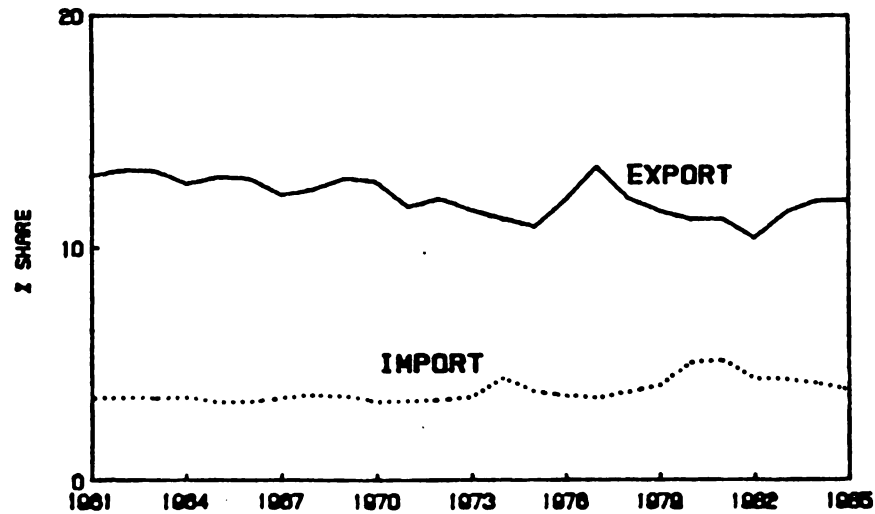
**WORLD AGRICULTURAL EXPORTS
(1961-1985)**



**LATIN AMERICA AGRICULTURAL TRADE
(1961-1985)**

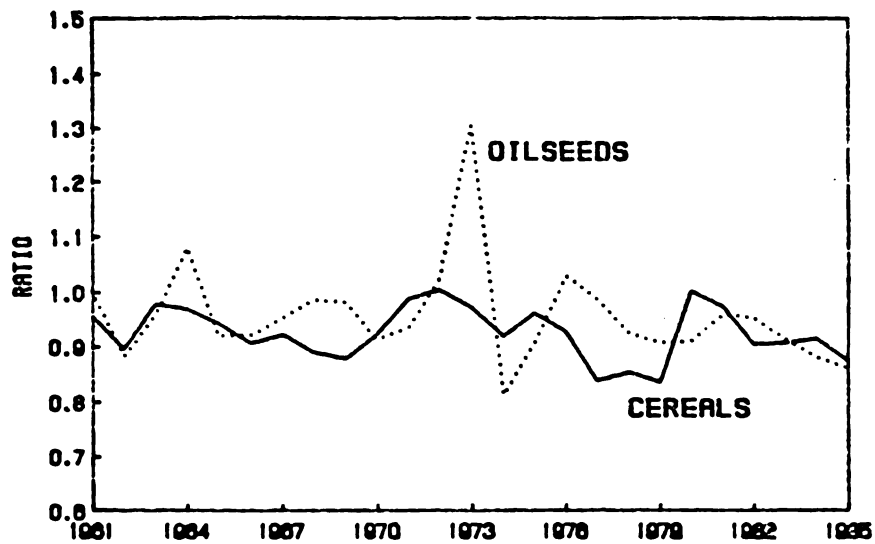


**LATIN AMERICA'S SHARE OF WORLD TRADE
(1961-1985)**

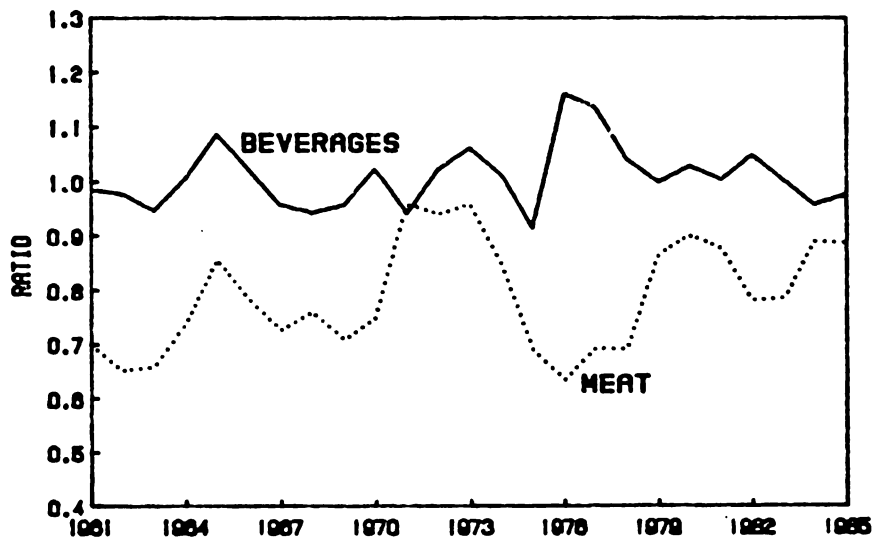


RATIO OF LATIN AMERICA TO WORLD EXPORT UNIT VALUE
(1961-1985)

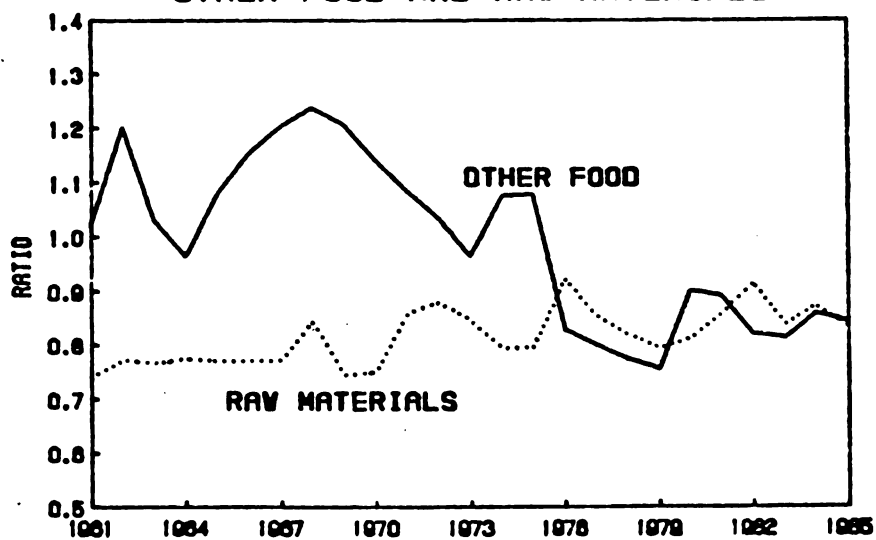
CEREALS AND OILSEEDS



BEVERAGES AND MEAT

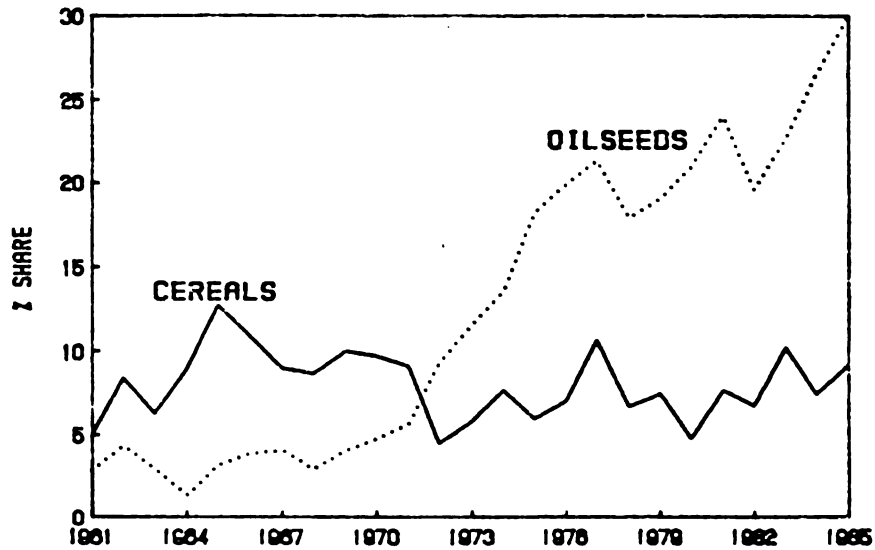


OTHER FOOD AND RAW MATERIALS

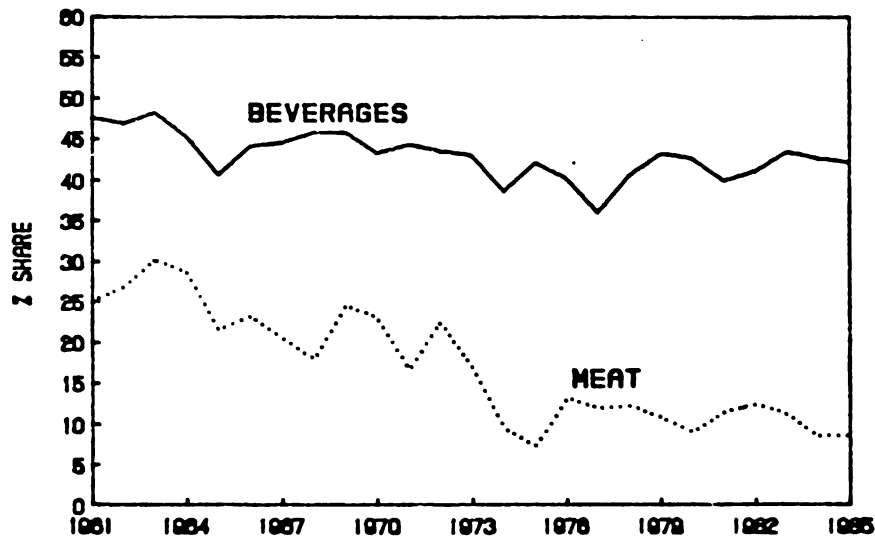


LATIN AMERICA'S SHARE OF WORLD AGRICULTURAL EXPORTS
(1961-1985)

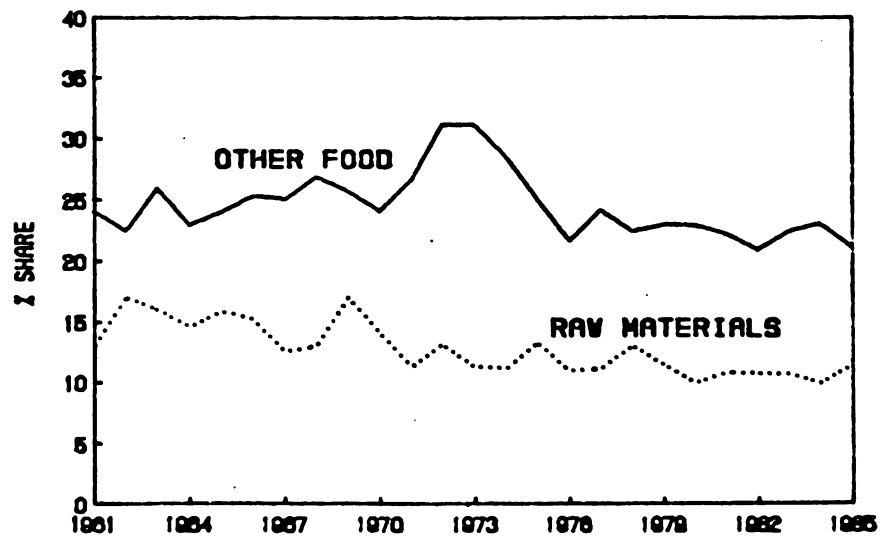
CEREALS AND OILSEEDS



BEVERAGES AND MEAT



OTHER FOOD AND RAW MATERIALS



MACROECONOMIC AND POPULATION ASSUMPTIONS

	Historical		Projections		
	1973-80	1980-86	1986-91	1991-1995	1995-2000
Real GDP Growth (% P.A.)					
Developing Countries	5.0	3.3	4.8	4.8	4.5
High-Income Oil Exporters	7.6	-1.5	4.1	5.3	4.5
Industrial Countries	2.8	2.3	3.2	3.3	3.3
Centrally Planned Economies					
USSR	3.4	2.6	2.3	2.3	2.3
Other E. Europe	2.9	1.8	2.1	2.1	2.1
World (excl. Centrally Planned)	3.4	2.5	3.6	3.7	3.4
Inflation (% P.A.)					
US GNP Deflator	7.8	4.9	4.6	4.0	4.0
Interest Rates (% P.A.)					
US Short Term (6 mo. nominal)	9.3	11.2	8.3	7.0	7.0
US Short Term (6 mo. real)	1.4	6.0	3.7	3.0	3.0
Exchange Rate (% P.A.)					
SDR/US\$	-1.3	1.9	-4.5	2.0	2.0
Population (% P.A.)					
Developing Countries	2.2	2.0	2.0	1.9	1.8
High Income Oil Exporters	5.2	4.4	3.8	3.5	3.2
Industrial Countries	0.7	0.5	0.5	0.4	0.4
Centrally Planned Economies	0.8	0.7	0.7	0.6	0.6
World	1.8	1.7	1.7	1.6	1.6

1970-2000

COMMODITY	UNIT	ACTUAL							SHORT RUN			LONG RUN			
		1970	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1995	2000
ENERGY															
PETROLEUM	S/BRL	3.6	29.2	32.7	30.0	27.9	27.7	26.7	11.4	13.3	14.0	13.6	13.9	17.3	24.7
COAL	S/MT	n.a.	41	54	51	44	49	47	37	33	34	33	37	42	46
FOOD															
COFFEE	¢/KG	316	330	269	298	288	321	321	361	262	249	249	267	270	277
COCOA	¢/KG	186	249	198	168	210	242	223	174	170	137	131	133	170	192
TEA	¢/KG	302	214	192	167	231	349	198	162	179	187	191	203	213	221
SUGAR	S/MT	223	603	337	180	183	116	90	112	129	146	183	213	243	253
BEEF	¢/KG	339	264	236	231	242	229	213	176	187	181	191	203	233	276
BANANAS	S/MT	456	363	383	342	423	373	380	336	338	333	331	349	333	321
ORANGES	S/MT	463	374	386	372	370	336	398	331	321	332	328	334	338	334
RICE	S/MT	397	416	460	283	273	234	216	177	173	180	191	207	212	216
WHEAT	S/MT	173	183	187	161	168	167	173	133	113	119	127	137	133	148
MAIZE	S/MT	161	120	123	106	133	137	112	74	60	67	79	93	93	98
GRAIN SORGHUM	S/MT	143	124	121	103	128	120	103	69	37	62	76	69	90	93
FATS & OILS															
PALM OIL	S/MT	717	339	344	431	497	733	501	216	233	263	296	330	430	420
COCONUT OIL	S/MT	1,093	643	343	449	724	1,163	390	230	273	312	343	400	500	482
GROUNDNUT OIL	S/MT	1,043	823	994	366	703	1,026	903	479	466	467	486	342	600	330
SOYBEAN OIL	S/MT	846	372	483	433	323	731	372	288	266	303	331	383	473	440
SOYBEANS	S/MT	322	284	273	237	279	283	224	173	167	173	181	194	203	200
COPRA	S/MT	620	433	362	304	492	717	386	166	178	203	222	260	323	312
PALM KERNELS	S/MT	463	331	303	236	362	333	291	119	128	146	160	187	244	234
GROUNDNUT MEAL	S/MT	281	230	227	183	198	189	143	139	133	138	140	146	144	140
SOYBEAN MEAL	S/MT	287	231	241	211	234	199	137	136	146	131	134	160	138	134
NON-FOOD															
COTTON	¢/KG	174	196	176	134	184	180	132	89	110	110	111	128	164	163
JUTE	S/MT	733	293	263	276	300	336	383	229	217	263	282	309	298	313
RUBBER	¢/KG	128	136	119	97	123	111	92	80	82	81	83	90	107	110
TOBACCO	S/MT	2,721	2,203	2,240	2,331	2,227	2,008	1,906	1,398	1,649	1,399	1,611	1,730	1,832	1,831
TIMBER															
LOGS (LAWN)	S/CM	103	183	148	131	144	169	136	123	133	131	128	139	143	137
LOGS (SAPELLI)	S/CM	119	241	203	170	160	177	174	186	196	187	183	193	194	203
SAWNWOOD	S/CM	236	339	299	292	302	310	276	223	233	222	213	221	233	231
METALS & MINERALS															
COPPER	S/MT	3,893	2,090	1,661	1,432	1,379	1,390	1,417	1,133	1,166	1,130	1,179	1,294	1,390	1,481
TIN	¢/KG	990	1,374	1,341	1,232	1,293	1,237	1,134	318	320	487	363	663	738	772
NICKEL	S/MT	7,841	6,244	3,673	4,678	4,636	4,796	4,899	3,264	3,242	3,120	3,090	3,236	3,272	3,239
ALUMINUM	S/MT	1,488	1,637	1,276	1,026	1,483	1,384	1,110	1,061	1,020	1,071	1,111	1,139	1,383	1,421
LEAD	S/MT	838	868	693	328	422	447	391	342	342	333	331	336	409	402
ZINC	S/MT	812	729	807	721	738	930	783	634	623	608	623	663	798	794
IRONE ORE	S/MT	41.9	23.6	23.2	23.0	23.8	23.4	22.7	18.3	18.2	16.9	16.1	16.4	13.8	14.9
BAUXITE	S/MT	33.1	39.3	38.1	34.8	34.4	33.3	38.0	23.3	21.6	20.2	21.1	23.2	23.6	27.2
FERTILIZERS															
PHOSPHATE ROCK	S/MT	30	43	47	41	37	39	34	29	28	30	29	32	33	37
UREA	S/MT	133	213	206	136	134	173	136	90	96	117	143	178	166	179
TSP	S/MT	117	173	134	134	134	133	121	102	98	109	113	124	143	134
DAP	S/MT	149	213	186	177	182	191	169	130	133	148	166	187	208	216
POTASSIUM CHLOR	/B S/MT	87	111	107	79	73	83	84	38	36	38	64	73	83	93

n.a. = NOT AVAILABLE

/A COMPUTED FROM UNROUNDED DATA AND DEFLATED BY MJV (1985 = 100). /B POTASSIUM CHLORIDE, ALSO KNOWN AS MURIATE OF POTASH.

SOURCE: WORLD BANK, ECONOMIC ANALYSIS & PROJECTIONS DEPARTMENT,
COMMODITY STUDIES & PROJECTIONS DIVISION

COMMODITY PRICE AND PRICE PROJECTIONS IN CURRENT DOLLARS /A

COMMODITY	UNIT	ACTUAL						SHORT RUN			LONG RUN				
		1970	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1995	2000
ENERGY															
PETROLEUM	\$/BRL	1.3	30.5	34.3	31.0	28.1	27.5	26.7	13.6	16.0	18.0	18.0	18.0	25.0	40.0
COAL	\$/MT	n.a.	43	57	52	45	49	47	44	42	44	46	48	60	77
FOOD															
COFFEE	¢/KG	115	344	282	309	290	310	321	429	315	320	330	345	390	440
COCOA	¢/KG	68	260	208	174	212	240	225	207	204	202	200	200	240	310
TEA	¢/KG	110	223	202	193	233	346	190	193	215	240	254	263	307	350
SUGAR	\$/MT	81	632	374	186	187	115	90	133	165	233	318	390	380	430
BEEF	¢/KG	130	276	248	239	244	227	215	209	224	232	234	285	368	447
BANANAS	\$/MT	168	379	401	374	429	370	380	400	406	428	439	452	484	520
ORANGES	\$/MT	168	391	405	385	373	352	398	394	385	426	436	458	488	541
RICE	\$/MT	144	434	483	293	277	252	216	211	210	231	254	268	307	350
WHEAT	\$/MT	63	191	196	167	170	165	173	161	138	153	169	178	195	228
MAIZE	\$/MT	58	125	131	109	136	136	112	88	72	86	103	121	157	159
GRAIN SORGHUM	\$/MT	32	129	126	109	129	119	103	83	69	80	98	115	130	131
FATS & OILS															
PALM OIL	\$/MT	260	584	571	445	501	729	501	257	280	337	393	453	650	680
COCONUT OIL	\$/MT	397	674	570	464	730	1,155	590	297	330	400	455	518	722	780
GROUNDNUT OIL	\$/MT	379	859	1,043	585	711	1,017	903	569	560	600	645	701	866	858
SOYBEAN OIL	\$/MT	307	598	507	447	527	724	572	342	328	390	440	496	684	712
SOYBEANS	\$/MT	117	296	288	245	282	282	224	208	200	224	240	251	296	324
COPRA	\$/MT	225	454	379	314	496	710	386	197	214	260	295	336	469	505
PALM KERNELS	\$/MT	168	345	317	265	365	528	291	142	154	187	212	242	352	379
GROUNDNUT MEAL	\$/MT	102	240	258	189	200	187	143	185	160	177	188	189	208	227
SOYBEAN MEAL	\$/MT	104	262	253	219	258	197	157	185	175	194	204	207	228	249
NON-FOOD															
COTTON	¢/KG	63	205	185	160	185	179	132	106	132	141	148	166	237	267
JUTE	\$/MT	274	508	276	286	302	531	383	272	260	340	375	400	430	510
RUBBER	¢/KG	46	162	125	100	124	110	92	95	98	104	110	116	156	178
TOBACCO	\$/MT	988	2,300	2,350	2,410	2,245	1,990	1,908	1,900	1,980	2,053	2,139	2,238	2,645	2,965
TIMBER															
LOGS (LALAN)	\$/CM	37	193	156	156	145	167	136	148	160	160	170	180	207	233
LOGS (SAPELLI)	\$/CM	43	232	213	176	161	176	174	222	235	240	245	250	280	332
SAWNWOOD	\$/CM	93	365	314	302	304	307	276	267	280	284	283	286	337	406
METALS & MINERALS															
COPPER	\$/MT	1,413	2,182	1,742	1,480	1,592	1,377	1,417	1,374	1,400	1,477	1,565	1,675	2,296	2,722
TIN	\$/KG	359	1,644	1,406	1,295	1,303	1,246	1,154	816	625	625	750	860	1,065	1,250
NICKEL	\$/MT	2,846	6,519	5,955	4,838	4,673	4,752	4,899	3,881	3,894	4,006	4,104	4,187	4,725	5,276
ALUMINIUM	\$/MT	340	1,730	1,338	1,061	1,493	1,371	1,110	1,261	1,225	1,375	1,475	1,560	2,000	2,300
LEAD	\$/MT	304	906	727	546	425	443	391	406	439	430	440	460	590	650
ZINC	\$/MT	293	761	846	745	764	922	783	754	750	780	830	860	1,140	1,286
IRON ORE	\$/MT	15.2	26.7	24.3	25.9	24.0	23.2	22.7	22.0	21.8	21.7	21.4	21.2	22.8	24.1
BAUXITE	\$/MT	12.0	41.2	40.0	36.0	34.7	33.0	30.8	28.8	26.0	26.0	26.0	30.0	37.0	44.8
FERTILIZERS															
PHOSPHATE ROCK	\$/MT	11	47	50	42	37	38	34	34	34	38	39	41	50	60
UREA	\$/MT	48	222	216	159	155	171	136	107	115	150	190	230	240	290
TSP	\$/MT	45	180	161	138	135	131	121	121	118	140	152	160	210	250
DAP	\$/MT	34	222	195	163	184	189	169	154	160	190	220	242	300	350
POTASSIUM CHLOR /B	\$/MT	32	116	112	82	75	84	84	69	67	75	85	94	120	150

n.a. = NOT AVAILABLE

/A COMPUTED FROM UNROUNDED DATA. /B POTASSIUM CHLORIDE, ALSO KNOWN AS MURIATE OF POTASH.

SOURCE: WORLD BANK, ECONOMIC ANALYSIS & PROJECTIONS DEPARTMENT
COMMODITY STUDIES & PROJECTIONS DIVISIONS

JANUARY 17, 1987

WEIGHTED INDEX OF COMMODITY PRICES /A
(CONSTANT DOLLARS)
(1979-1981=100)

(WEIGHTS- % SHARE)/B	PETROLEUM	33 COMMODITIES (EXCLUDING ENERGY) (100.0)	ANNUAL AVERAGES								TIMER METALS & MINERALS (27.1)
			TOTAL (67.7)	AGRICULTURE				NON-FOOD (14.4)	OTHER (12.3)		
				TOTAL (53.2)	BEVERAGES (22.3)	CEREALS (9.4)	FATS & OILS (9.3)				
1948	8	31	34	33	24	42	32	28	39	12	27
1949	7	30	32	32	26	43	39	26	34	13	28
1950	6	35	39	39	34	41	41	28	33	13	28
1951	6	42	46	39	38	45	49	30	73	19	36
1952	6	39	39	36	36	44	41	28	50	15	42
1953	7	36	37	37	37	44	41	28	39	13	38
1954	7	39	41	42	32	41	38	28	39	18	36
1955	7	38	39	36	41	36	36	28	47	15	42
1956	7	39	39	38	43	37	37	29	43	14	44
1957	7	37	38	37	40	35	37	33	42	14	39
1958	7	34	35	34	36	35	33	29	39	13	37
1959	6	34	35	32	32	34	37	28	44	15	36
1960	5	34	35	31	31	32	35	28	46	17	37
1961	5	33	33	31	29	33	37	27	39	17	36
1962	5	33	33	31	28	38	35	28	39	19	35
1963	5	33	34	33	28	38	37	37	36	19	34
1964	5	36	35	34	32	38	38	34	37	16	42
1965	5	37	34	33	30	37	42	28	36	18	48
1966	5	38	34	34	30	42	41	28	37	19	51
1967	5	36	34	33	29	44	39	30	35	21	43
1968	5	36	34	33	29	43	37	30	36	21	44
1969	5	38	35	34	30	43	37	33	39	20	49
1970	5	40	37	37	34	39	43	35	36	21	51
1971	6	37	35	35	30	38	44	35	37	22	44
1972	7	39	38	38	33	40	43	42	38	22	44
1973	10	59	59	59	42	81	88	51	59	38	63
1974	40	78	78	82	48	118	100	101	66	45	84
1975	39	65	65	66	46	92	87	84	58	34	73
1976	42	73	76	77	88	75	72	62	73	46	72
1977	46	88	96	103	148	69	89	56	74	53	74
1978	46	84	89	92	110	83	93	66	80	56	76
1979	67	98	99	100	114	87	106	80	96	98	97
1980	110	108	107	107	102	103	99	125	109	113	108
1981	123	94	94	93	85	110	95	95	95	90	95
1982	112	84	83	83	87	80	77	81	84	90	85
1983	101	88	89	87	88	87	91	85	94	84	88
1984	99	90	92	93	101	83	107	75	88	96	83
1985	96	79	80	82	93	73	75	73	73	78	78
1986	49	80	83	87	114	64	58	78	67	83	72
1987	58	76	76	77	91	57	58	81	74	92	72
1988	65	80	81	82	93	65	66	86	78	97	75
1989	63	83	86	87	96	74	73	91	82	98	79
1990	63	90	91	92	100	82	78	95	89	104	83
1995	90	109	109	107	114	92	98	110	118	119	105
2000	144	125	125	122	134	107	105	126	133	146	122

A/ COMPUTED FROM UNROUNDED DATA AND DEFLATED BY MANUFACTURING UNIT VALUE (MUV) INDEX

B/ WEIGHTED BY 1979-1981 DEVELOPING COUNTRIES EXPORT VALUES

NOTE: THE COMMODITIES INCLUDED IN EACH GROUP ARE: BEVERAGES-COFFEE, COCOA, TEA; CEREALS-MAIZE, RICE, WHEAT, GRAIN SORGOEM; FATS AND OILS-PALM OIL, GROUNDNUT OIL, SOYBEANS, COPRA, GROUNDNUT MEAL, SOYBEAN MEAL; OTHER FOODS-SUGAR, BEEF, BANANAS, ORANGES; NON-FOODS-COTTON, JUTE, RUBBER, TOBACCO; TIMER-LOGS; METALS AND MINERALS-COFFER, TIN, NICKEL, BAUXITE, ALUMINUM, IRON ORE, LEAD, ZINC, PHOSPHATE ROCK

SOURCE: WORLD BANK, ECONOMIC ANALYSIS & PROJECTIONS DEPARTMENT, COMMODITY STUDIES & PROJECTIONS DIVISION
JANUARY 17, 1987

WEIGHTED INDEX OF COMMODITY PRICES /A
(CURRENT DOLLARS)
(1979-1981=100)

(WEIGHTS- % SHARE)/B	PETROLEUM	33 COMMODITIES (EXCLUDING ENERGY) (100.0)	ANNUAL AVERAGES								
			TOTAL (67.7)	AGRICULTURE			NON-FOOD			TIMER METALS & MINERALS (27.1)	
				TOTAL BEVERAGES (53.2)	FOOD CEREALS (9.4)	FATS & OILS (9.3)	OTHER (12.3)	(14.4)			
1948	30	112	124	119	86	134	109	101	140	43	97
1949	26	113	121	119	100	163	148	100	129	47	105
1950	26	130	168	152	147	178	177	122	228	57	122
1951	23	136	172	146	141	166	182	111	271	72	132
1952	22	138	140	130	128	157	147	98	179	52	148
1953	24	132	136	134	134	161	151	100	142	48	137
1954	26	145	155	138	193	154	143	104	144	68	134
1955	23	140	142	133	152	133	130	103	173	53	134
1956	24	138	138	134	134	130	129	103	153	50	155
1957	24	128	131	128	138	121	128	114	145	47	136
1958	22	118	120	117	123	121	118	99	131	44	126
1959	20	117	120	111	110	117	128	95	152	53	124
1960	18	116	117	106	105	109	120	98	157	57	124
1961	18	110	109	103	97	115	124	89	131	58	120
1962	17	107	107	101	91	125	114	91	129	62	115
1963	17	111	113	110	92	127	122	122	121	62	114
1964	19	117	114	112	103	124	123	111	121	52	137
1965	15	119	109	107	98	120	136	91	117	59	155
1966	15	119	107	105	93	131	128	89	115	60	160
1967	15	111	105	104	89	137	128	92	108	64	134
1968	15	112	105	102	89	134	115	93	113	66	138
1969	14	113	104	101	88	127	108	98	113	60	144
1970	13	111	103	103	96	109	121	97	101	60	142
1971	16	98	94	93	80	100	116	94	97	58	117
1972	17	94	92	93	80	97	104	103	91	53	106
1973	20	124	124	124	88	170	185	107	124	79	133
1974	69	134	135	140	83	202	172	173	114	78	144
1975	61	101	100	103	71	142	104	129	89	53	113
1976	64	112	116	117	134	113	110	95	111	70	110
1977	64	123	134	143	205	96	124	78	102	74	103
1978	36	101	108	111	132	100	112	79	97	68	92
1979	71	103	106	106	121	92	114	86	102	104	103
1980	107	103	104	104	99	101	96	121	106	110	103
1981	119	91	91	90	82	107	92	92	92	87	92
1982	109	82	81	81	83	79	76	79	82	88	83
1983	102	89	89	88	88	87	92	83	93	84	88
1984	101	92	94	93	104	83	110	77	90	99	83
1985	98	81	81	83	93	74	76	74	74	80	79
1986	42	68	71	74	97	34	30	66	37	73	61
1987	49	64	64	63	77	48	49	69	62	78	61
1988	31	63	64	63	74	31	32	68	62	77	59
1989	30	63	66	67	73	37	36	70	63	75	61
1990	31	70	71	72	78	64	61	73	69	81	63
1993	63	76	77	73	80	63	69	78	83	84	74
2000	90	78	78	77	84	67	66	79	84	91	76

/A COMPUTED FROM UNROUNDED DATA

/B WEIGHTED BY 1979-1981 DEVELOPING COUNTRIES EXPORT VALUES

NOTE: THE COMMODITIES INCLUDED IN EACH GROUP ARE: BEVERAGES-COFFEE, COCOA, TEA; CEREALS-MAIZE, RICE, WHEAT, RAIN SORGOEM; FATS AND OILS-PALM OIL, COCONUT OIL, GROUNDNUT OIL, SOYBEANS, COPRA, GROUNDNUT MEAL, SOYBEAN MEAL; OTHER FOODS-SUGAR, BEEF, BANANAS, ORANGES, NON-FOOD-COTTON, JUTE, RUBBER, TOBACCO; TIMER-LOGS; METALS AND MINERALS-COFFER, TIN, NICKEL, BAUXITE, ALUMINUM, IRON ORE, LEAD, ZINC, PROSPHATE ROCK.

SOURCE: WORLD BANK, ECONOMIC ANALYSIS & PROJECTIONS DEPARMENT
COMMODITY STUDIES & PROJECTIONS DIVISION

JANUARY 17, 1987

COMMODITY DESCRIPTIONENERGY

Petroleum, average OPEC price (OPEC government sales weighted by OPEC exports)
 Thermal Coal, (12,000 BTU/lb, 1.0% sulfur, 12% ash), FOB Piers, Hampton Roads, Norfolk.

FOOD

Coffee (ICO), indicator price, other mild Arabicas, average New York and Bremen/Hamburg markets, ex-dock for prompt shipment.
 Cocoa (ICCO), daily average price, New York and London, nearest three future trading months.
 Tea (London Auction), average price received for all teas.
 Sugar (World), ISA daily price, FOB and atowed at greater Caribbean ports.
 Beef (US), imported frozen boneless, 85% visible lean cow meat, FOB port of entry.
 Bananas (Central and South American), first-class quality tropical pack, FOB US ports.
 Oranges (Mediterranean Exporters), EEC indicative import price, DIF Paris.

CEREALS

Rice (Thai), white, milled, 5% broken, government standard, export price, FOB Bangkok.
 Wheat (Canadian), No. 1 Western Red Spring (CWRS) 13.5%, basis in store Thunder Bay, domestic; form April 1985, St. Lawrence, export.
 Maize (US), No. 2, yellow, FOB Gulf ports.
 Grain Sorghum (US), No. 2, Milo yellow, FOB Gulf ports.

FATS AND OILS

Palm Oil (Malaysian), 5% bulk, CIF N.W. Europe.
 Coconut Oil (Philippines/Indonesian), bulk, CIF Rotterdam.
 Groundnut Oil (Nigerian/West African), bulk CIF UK, through January 1977; subsequently (any origin), CIF Rotterdam.
 Soybean Oil (Dutch), crude, FOB ex-mill.
 Soybeans (US), CIF Rotterdam.
 Copra (Philippines/Indonesian), bulk, CIF N.W. Europe.
 Palm Kernels (Nigerian), CIF UK
 Groundnut Meal (Indean), 48% CIF Rotterdam; from 1982, Argentina, 48/50%
 Soybean Meal (US), 44% extraction, CIF Rotterdam.

NON-FOOD

Cotton (Outlook "A" Index), Middling (1-3/32"), CIF Europe.
 Jute (Bangladesh), white D, FOB Chittagong/Chaina.
 Rubber (RSS No. 1), in balas, spot New York.
 Tobacco (Indian), flue-cured, average export unit value.

TIMBER

Logs (Philippines), Lauan, for plywood and veneers, length over 6.0 M., diameter over 60 cm., average wholesale price in Japan.
 Logs (West African), Sapelli, high quality, loyal and marchand, FOB Cameroon.
 Swanwood (Malaysian), Dark Red Meranti, select and better quality, standard density, CIF French ports.

METALS AND MINERALS

Copper (LME), cash wirebars through November 1981; from December 1981 through June 1986, high grade cathodes, settlement price; subsequently, grade A.
 Tin (Malaysian), Straits quality, ex-smelter, Penang, official settlement price.
 Nickel (Canadian), electrolytic cathodes, 99.9% shipping point; from 1980 (LME) cathodes, minimum 99.8% purity, official morning session weekly average bid/asked price.
 Aluminium (Representative Free Market Price), ingots, 99.7% purity, transactions price, EEC duty paid.
 Lead (LME), settlement price, refined lead, purity 99.9%.
 Zinc (LME), settlement price, good ordinary brand; from Sept. 1984, High Grade Brand.
 Iron Ore (Brazilian), 65%, CIF North Sea ports.
 Bauxite, US import reference price based on imports from Jamaica.

FERTILIZERS

Phosphate Rock (Moroccan), 72% BPL, FAS Casablanca; from 1981, 70% TPL contract.
 Urea (any origin), bagged, FOB N.W. Europe.
 TSP (Triple Superphosphate), bulk, FOB US Gulf.
 DAP (Diammonius Phosphate), bulk, FOB US Gulf.
 Potassium Chloride (Muriate of Potash), bulk, FOB Vancouver.

January 17, 1987

INTERNATIONAL ECONOMIC CONDITIONS FOR AGRICULTURAL TRADE: THE QUEST FOR STABILITY AND COOPERATION

A. SUMMARY

Presentation

It should be stressed that forecasting techniques are rather imprecise and require constant revisions. This would appear to be especially valid for short-term prospects, since the long-term predictions change with greater regularity.

The focus of this presentation is on long-term prospects for the performance of basic commodity prices, although admittedly the more pressing problem is that of the short term.

One of the first factors to be underscored was the downward trend of commodity prices in the long term, as illustrated by the behavior of wheat prices in the United States in the period from 1960 to 1985.

The long-term performance of Latin America's basic export products may be interpreted as representing the end of a price cycle showing a continuous long-term decline. And although no significant change is anticipated in the near future, it is highly probable that they will not fall much lower.

A glance at the lessons of the past --i.e., the events of the 60s-- is very illuminating, in the sense that agriculture has displayed considerable capacity for response that could not have been predicted at the time. This expanded supply, together with the worst recession the world has known starting in 1981, generated enormous surpluses, many of which were dumped on the international market, pushing prices down.

The World Bank's forecasts for the next 15 years are based on the following macroeconomic assumptions: 1) a forecast as to the growth of the gross national product in both developed and developing countries that is highly optimistic but, at the same time, very moderate (average annual growth ranging from 2.3 to 3.3%); 2) an inflation rate in forthcoming years of 4.6% until 1990 and 4% by the turn of the century; 3) continuation of the dollar devaluation rate, but at a slower pace; and 4) an average annual growth rate of 1.6% for the world's population.

Within that general frame of reference, the weighted index of agricultural commodity prices is expected to recover somewhat during the rest of the decade, without however falling short of its 1985 levels in real terms.

Varying situations were described with respect to specific products, involving the behavior of consumption patterns stemming from the agricultural sector policies and adopted by the industrialized countries and the degree of protection they afford. In the short term, the prices of such products as maize and beef are greatly influenced by the current oversupply, making it very likely

that they will remain at their present low levels for the next several years. In other cases, such as oilseeds, the performance of prices will remain relatively weak because of their close ties to grain and maize supplies, particularly in view of the accelerated production of African palm oil.

World trade trends in agricultural and livestock commodities over the 1960-1980 period were relatively favorable, although Latin America's share of world exports declined, except for oilseeds. Its share of imported farm commodities on the other hand rose slightly.

In retrospect, certain sensitive areas should be noted that were not adequately calibrated at the time of the price forecasts. They are the following: 1) the trend in Soviet Union demand for grain and oilseeds on the world market, which were not so much the result of weather conditions as of changes in income levels; 2) the energy crunch and the spectacular surge in oil prices. This in turn changed the prices of fertilizers, among other items, thus obviously affecting commodity profitability. The rise of OPEC and the recycling of petrodollars altered the redistribution of income between developed and developing countries 1/. 3) Another item that was overlooked in the forecast was the recession of the early 80s, which triggered a drastic downturn in world demand that coincided, for reasons discussed previously, with a sharp increase in the supplies of agricultural products. That scenario, fortunately, ended well by shoring up the sagging trend in basic commodity prices --thus underscoring, once again, the fact that the ability of farm commodities to respond to world demand had assuredly been underestimated.

Given these developments, it would seem expedient and necessary to remember that current price forecasts can be affected by: 1) underestimating increments in the national product --hence in income-- in both developed and developing countries; 2) failing to realize that another energy crisis and a new hike in oil prices might take place toward the end of this decade and the beginning of the next, thus significantly altering the equilibria of international trade in agricultural and livestock commodities; and 3) the failure, on the supply side, to keep pace with scientific and technological progress. The "green revolution" seems to have reached its zenith; but it may well happen that "biotechnology" will surprise us, as did the "green revolution" in earlier decades.

1/ A factor that is largely responsible for the levels of external indebtedness in the developing countries.

Comments

There is a clear-cut need to recognize that the possibilities of developments (or forecasts) of basic commodity prices are predicated on uncertain factors that are difficult to quantify. Suffice it to cite the significant variations in a series of areas that were not anticipated in timely fashion: the energy crisis, world recession, financial movements, and the like.

When we recognize worldwide integration of the basic commodity market to be a fact, a series of factors may be seen to exist in the world market that are much more complex than the variables which determine supply and demand. These factors send signals to the market in the short term. Guided by those signals, the producers do not act on the basis of long-term trends.

At present there is a much higher level of speculation concerning the price outlook for farm products. For example, a series of factors could be cited beyond the strict confines of supply and demand, which affect the prices of basic commodities: 1) currency variations; 2) the structures of the large countries' agricultural protection policies; and 3) the intrinsic structure of the opportunity cost of financial resources to many of the producers of basic exportable goods.

Given these factors of speculation and uncertainty, we should ask ourselves what would happen, for example, in the face of low interest scenarios that would alter the opportunity cost of stockpiling vis-a-vis the opportunity cost of capital flows from traditional private banking systems. Nor is there any certainty regarding the future of the OECD countries' policy on subsidies, the quantity of which is so vast that they are intolerable when compared with the economic capacity of those countries.

On the other hand, the situation described concerning the limits of supply imposed in developing countries by constraints on the "green revolution" might be indicative of greater market activity, provided that financing mechanisms can be set up to transfer those surpluses, in terms of agro-livestock production, from the OECD countries to the LDCs.

While the presentation centered on an analysis of long-term price trends for exports for agricultural and stockraising sources, it was noted that the most serious problems facing the developing countries stem from the short-term crisis. An analysis of this scenario therefore becomes mandatory.

Some interesting ideas were mentioned in connection with the reasonably downward trend of long-term international prices expressed in constant currency: 1) we should not lose sight of nor fail to analyze the significance of self-sufficiency policies, particularly in the developed countries, contrary to the indications of international markets. For example, the decisions of the 70s resulted in policies that today are proving very costly to the countries that made them, with the obvious further consequence of an extremely adverse effect on the countries that are now in a position to export

such goods; 2) we must stress the importance of future competitiveness and be keenly aware of the factors that make it possible --particularly since technological change is a fundamental variable that must be taken into account in addition to natural advantages; 3) if the price signals in international markets begin to play a more antagonistic role, it is important to be alert to all factors involving subsidies or changes in trade that may in any way make it difficult to define the nature of a market, the meaning of a price and what each price represents. In this respect, for example, the prices of developing countries that do not include subsidies cannot be compared with subsidized prices. Furthermore, the developing countries are unable to compete with the developed countries when the latter offer generous financing schemes.

As to the short-term situation, it should be emphasized that the crisis confronting Latin America is, to some extent, exogenous and it constitutes a response to --or, rather, a result of-- the industrialized countries' development policies. Given this crisis, the cudgels of development must again be taken up most forcefully, for only the highest levels of development can guarantee recovery in the configuration of world demand.

The other determining factor in the short term has been the oversupply of various agricultural and livestock products on the world market, resulting from the protectionist policies of the developed countries.

Under these conditions, broad and sustained efforts must be made to find a solution to the crisis, both in the area of policy accords and in such negotiation forums as the GATT and the commodity agreements. At the same time, the levels of cooperation within the region must be increased in the fields of information, science and technology.

Finally, emphasis was placed on the need to be aware that the developing countries have very little space for maneuvering, and to give considerably more thought to the possibility that commitments to meet the requirements of external debt might have an adverse effect on the revitalization and structural adjustment policies of the Latin American countries.

B. DISCUSSION DOCUMENT

Agriculture in the GATT negotiations: Implications for developing countries 1/

Developing countries (LDCs) typically have open economies in which agriculture is of substantial, if not dominant, importance. For most LDCs, the conditions they face in world markets largely determine the options open to them in formulating their own development strategy. Conditions in the international commodity markets, and the financial and exchange rate markets, along with foreign assistance, delineate the external environment that will be a major determinant of the economic prospects for LDCs for the next decade. For many LDCs, agricultural trade is an engine of growth. They depend heavily on agricultural exports for their balance of payments and for income. Also, international trade is an integral part of food security for many LDCs that use food imports to supplement domestic output.

Protectionism vs Liberalization

The degree of protection given to agriculture in the developed countries is significantly greater than that given to manufacturing. In most LDCs however, agriculture is usually taxed and manufacturing is protected from import competition.

In world markets, trade in temperate region products and in some tropical products, like sugar, is influenced most by the degree of protection those products are given in the developed countries. These industrialized countries are the dominant actors in most agricultural trade.

There are two dimensions of the direct external effects of farm policy in industrial countries: depressing effects on world prices and higher instability in these prices. Indirectly, the threat of protection is an important deterrent to the opening of LDC economies. The current levels of protection and the unilateral and unpredictable nature of access to industrial-country markets affects the willingness of policymakers and producers in LDCs to assume the risks associated with a more trade-oriented strategy. The outcome is often a more inward-looking trade policy, at the cost of employment and economy growth for most LDCs.

1/ The original document was prepared in English by Economist Alberto Valdés (International Food Policy Research Institute - IFPRI) for the World Bank Institute for Economic Development. It does not necessarily reflect the opinions or official policy of the World Bank or the Interamerican Institute for Cooperation on Agriculture.

Developed country trade restrictions include both tariffs and nontariff barriers, which vary considerably in severity among countries and products. They tend to lower world prices by artificially reducing domestic consumption and raising domestic production in developed countries. As a consequence, the volume of exports from both LDCs and developed countries are reduced. The effects of price and volume both translate into a foreign exchange and welfare loss to LDCs. On the other hand, as net importers of cereals, milk powder and other goods several Latin American countries have benefited from low world prices of basic food staples --to a larger extent the result of the protection afforded these products in developed countries.

Effects of protection

A few studies have assessed the effects of agricultural protection in developed countries on world market prices, export earnings, and import costs, and the resulting welfare gains and losses of developed countries and LDCs. Although exact measurements are impossible to make, available estimates can provide an approximation of the extent of protection and its implications for the balance of trade of LDCs, both as exporters and importers.

Latin America is not a homogeneous block of agricultural exporters shipping tropical raw materials to the industrial world. There are many countries, many commodities, as well as importers and exporters of both tropical and temperate zone goods, facing different levels of restrictions in terms of market access. Above all, there are consumers and producers at different levels of income. It has been one of the objectives of the IFPRI studies on this topic to try to unravel the complex pattern of the incidence of agricultural protection in OECD countries on LDCs.

LDC Export revenues and imports

Results of a hypothetical 50 percent reduction across-the-board in tariffs and other trade barriers for 99 commodities in 17 developed countries, members of the OECD indicate that LDCs' annual export revenue would have increased by \$6 billion in 1985 prices (Table 1). This increase in export revenues represents an 11 percent increase for LDCs as a whole and an 8.5 percent increase for low-income countries taken separately. These figures were computed using 1977-79 levels of protection and trade flows. Trade flows and OECD protection have increased since 1977-79, so that the benefits of liberalization would be substantially greater in 1985. A recent update of the study using 1979-81 levels of protection and trade flows, but restricted to sugar, beef, wheat, and maize, concluded that export revenues for LDCs as a whole would increase by approximately U.S. \$10 billion per year from removal of protection in OECD countries in those four products.

On the imports side, Latin America's import costs on cereals from trade liberalization in OECD countries would increase substantially. For all LDCs, the increase would be on the order of at least \$1.3 billion per year.

Table 1-- Change in Export Revenue, Import Cost, and Efficiency for Selected Commodities of Developing Countries caused by a 50 percent decrease in OECD tariff rates, 1975-77

	Absolute Increase		
	All developing countries ^a	Low-income countries	Middle-and high-income countries
(millions of 1985 dollars)			
Change in export revenue			
Sugar	2,108	394	1,714
Beverages and tobacco	686	191	495
Meats	655	33	620
Coffee	540	123	417
Vegetable oils	400	60	339
Cocoa	287	21	265
Temperate-zone fruits and vegetables	197	60	137
Oilseeds and oil nuts	109	19	90
Other commodities	883	96	788
Total increase of all exports	5,866	998	4,867
Change in import costs			
Cereals	-876	-530	-345
Other commodities	-497	-152	-345
Total	-1,373	-683	-690

Source: A. Valdés and J. Zietz. Agricultural Protection to the OECD: Its Cost to Developing Countries, IFPRI, Research Report 21, 1980. Calculations based on 1975-77 trade flows. Update of the study using 1979-81 levels of protection and trade flows is available on request.

General Agreements on Tariffs and Trade (GATT): The Uruguay Rounds

This Round offers a unique opportunity for greater integration of LDCs into the trading system under clearer and fairer rules for agricultural trade. The challenge today is to identify the emerging issues of particular interest to LDCs related to agriculture in the GATT framework, in the context of the forthcoming Uruguay Round.

The question then is what should LDCs be seeking from the Uruguay Round, what can they offer, and what should they watch for that might be against their interests? Three sets of issues are considered here. The first concerns direct measures increase LDCs' access markets. Ideally agricultural trade liberalization under GATT should emphasize "nontariff" barriers and should go beyond border regulations. Considering the importance of nontariff barriers, negotiations should concentrate less on reciprocity in trade flows and more on reducing domestic prices in OECD countries. The principal cause of the problem is the high price wedge between domestic and border prices in several OECD countries. A reduction of protection would reduce the need for specific rules on many current and future trade barriers.

The second is strengthening GATT rules and disciplines. Strengthening GATT procedures for surveillance and settling disputes is essential for LDCs. Selecting safeguards by which some countries can be singled out as targets for protective measures is extremely dangerous, as LDCs are weak in bilateral bargaining.

The last is reciprocity. Because of their limited clout in the world market, developing countries should be particularly interested in becoming active participants in an international system that could provide a framework of norms, rules, and procedures. As such, they must offer some "incentives" to the trading powers in order to be considered and become more influential.

These incentives could come from two fronts. First, LDCs must be prepared to reciprocate in trade concessions, which could take the form of trade liberalization in industrial products in their own economies. Empirical evidence has shown that high industrial protection helps industry at the expense of agriculture and other exportables. This liberalization could be a useful bargaining tool for LDCs, and in the process, could help promote their agriculture. This implies also that agriculture should not be negotiated separately from other sectors.

Second, rather than emphasize the North-South issues per se, a fresh approach would be to focus negotiations on specific issues of high priority to both developed and developing countries. The Cairns Group, created in 1986, is a promising development along these lines. In the process, LDCs should be prepared to distinguish the rights and obligations of smaller lower-income LDCs from those of middle-income LDCs, leaving trade preferences exclusively for the poorest. Latin America has the opportunity to provide enlightened leadership at the Uruguay Rounds, representing a predominately middle-income group of countries.

X. NATIONAL ADJUSTMENT POLICY OPTIONS

A. SUMMARY

Presentation

In order to understand the nature of the adjustment process, we must draw a distinction between adjustment policies and stabilization process. The stabilization process --which is accompanied by a slackening in the growth rate of the major economic variables-- neither implies nor entails changes in the real structure, nor does it present problems of redistribution costs or outlays of a social nature. An adjustment policy, on the other hand, requires alteration of the true production structure, which in essence means that the sectors producing internationally tradeable goods will account for an increased share of the total product.

In addition to their contrasting natures, the adjustment and stabilization processes differ in the kind of policies or instruments they use and the speed with which they can be corrected. In adjustment policies, this must necessarily be a gradual process.

The need for gradual adoption of the adjustment policies becomes evident in the light of the economic and social costs that have been incurred by the Latin American countries. That cost has been not only high, but protracted in time.

The reasons underlying such high economic and social costs consist essentially of the following: 1) the structural weakness of Latin American economies in the early 80s; that weakness was exacerbated by an external debt that had outstripped exports by 150%, two thirds of it having been contracted at floating interest rates; furthermore, exports represented only a small fraction of the Regional Gross Internal Product, and basic commodities accounted for three quarters of those total exports; and 2) the extremely adverse external trade conditions under which the adjustment process had to be implemented.

Latin America had to face a waterfall decline in net capital receipts, with net flows dropping from an average of US\$37,000 million in 1981 to US\$3,000 in 1983, and then recovering somewhat to reach US\$6,000 million between 1984 and 1986. Up to 1981 Latin America received a net inflow of capital that exceeded the payments abroad for interest and profits. After 1982 that situation changed radically, shifting in five years to a net external transfer of about US\$130,000 million. The resultant impact on the balance of payments transcended that of the worsening terms of trade.

In practice, overseas transfers of net resources by Latin America represent a leakage of internal savings, thus curtailing the possibilities of underwriting domestic investment. This automatically reduces the growth rate, which in a circular process of cause and effect diminishes the capacity for imports, thereby stunting the growth potential of those economies.

The trade scenario, as noted earlier, has seen an unfavorable evolution of the prices of export products, explained in large part by the waning growth rate in both developed and developing countries, plus the increase in agricultural protectionist policies pursued by the countries of the north.

The challenge facing the Latin American countries is the establishment of an adjustment process compatible with economic growth --in other words, an expansive adjustment process that will achieve growth along with external balance. To accomplish that goal, the following are required, as a minimum: 1) inversion of the priorities in that process to guarantee a minimal economic growth rate based on a very limited volume of imports and, residually, guaranteeing the debt service; 2) a cutback in transfers of resources abroad, either through a decrease in interest payments (reduction in the basic interest rates) or by setting a ceiling on such payments, based either on the price of some export product or on the domestic product. Other possible measures would be to offer incentives for the repatriation of flight capital, or to attract a larger influx of external loans and investments, although the latter possibility depends essentially on the public international banks 1/; 3) finally, there is the alternative of cancellation of part of Latin America's external debt.

The feasibility of an expansive adjustment for Latin American countries hinges mainly on a reorientation of the development process, which is largely an internal responsibility. The central feature of such reorientation involves policies whose chief objective is to spur the rate of economic growth by means of heightened participation of the sectors that produce tradable goods in the overall economy. Only then will such growth be compatible in the long term with external equilibrium.

The possibility, of an expansive adjustment policy for Latin America must include variable combinations of at least three types of policies: 1) policies to control aggregate demand; 2) policies designed to change the relative prices of tradable and nontradable goods; and 3) policies for investment and processing of the output, to bring about a restructuring of production in the long term that would either boost the relative participation of the exporting sectors or produce substitutes for imports.

Among the specific instruments of an expansive adjustment policy, mention should first be made of an exchange policy that would make exports and import substitutes more profitable by using an effective real rate of exchange. This instrument is easy to manage, does not elicit resistance abroad, and is not discriminatory. Another instrument is the trade policy, which is more complex from the administrative point of view and creates problems of external resistance and those of a fiscal nature, but nevertheless affords greater selectivity in promotion policies.

1/ This is a quite theoretical possibility in the short term, mainly for countries with average incomes --which is the level of most Latin American countries.

Experience has shown that the specific measures relevant to trade policies must be selective. They must also provide temporary incentives. This assumes that the target activities will flourish and become internationally competitive in the future. (Exceptions to the temporary qualification may be established, such as a food security policy, for example).

Policies for processing of the output are a key element in the features of expansive adjustment. But the feasibility of achieving a substantial and sustained upturn in exports is subject to the necessary reorientation of public spending policies that support the agricultural sector, particularly those that provide assistance for tradable goods.

In short, the expansive adjustment policies will depend on the external context, the effort expended, and the internal policies. The analysis to be made must nevertheless distinguish between temporary and structural situations as well as the situations faced by the different countries, particularly the circumstances existing in regard to the various commodities.

Although the outlook for traditional products is not promising, a survey must nevertheless be conducted item by item, including the various options in accordance with the target market. Furthermore, there have been cases of relative success with exports of nontraditional commodities in the last few years. We must not forget that adjustment policies in many countries may rely on the development and export of industrial goods, which will reinforce efforts on behalf of agricultural and livestock products. The initial requirement and basic watchword in this respect is: "to believe that it can be done".

Comments

Once the differences between adjustment and stabilization have been established, there remains the specificity of such policies, which could bring very serious social repercussions in their wake, given their impact on income and consumption. In terms of cost, this depends on the pace and extent of the application of those policies, as well as the sequence and simultaneity of the adjustment and stabilization processes.

It was acknowledged in regard to the pace and cost of the stabilization processes that good results had been obtained by using shock treatment to attain stability, as in the case of Bolivia. In situations involving significant external imbalances, however, it was recommended that adjustment be gradual, since this might cushion the impact on the most vulnerable groups resulting from a further downturn in real wages.

As to the sequence of the stabilization and adjustment processes, certain experiences had led to the conclusion that in the case of extreme disequilibria, stabilization was to be recommended, but that the sequence of events therein would vary according to the circumstances of each country. In situations of hyperinflation (the case of Peru), it was found advisable to favor a program of expansive stabilization as a first phase, followed by expansive

adjustment. When the imbalances were not too marked, the processes of stabilization and adjustment could evolve simultaneously. In view of the implicitly complex nature of this scenario, however, the feasibility of the economic policy in terms of growth, stabilization and adjustment would, in the last instance, be defined by the inherent economic, social and political specifics of each country.

It is relatively true that sooner or later, in one way or another, all countries have to face adjustment policies --not of adjustment per se, but adjustment that includes growth. This takes time and must be achieved gradually, for it is a phenomenon of structure, not conjuncture. The situation is even more valid for the agricultural sector, given its productive nature.

The implementation of adjustment policies in Latin American countries must cope with serious constraints in respect to technology and availability of capital, and this is why it is realistic to shift priorities to accommodate development, making external debt payment subject to that capacity, and not the other way round.

In the context of defining adjustment policies that include growth, in which external factors frequently predominate, Latin America requires, or is forced to offer, a forceful response in accordance with an endogenous development that allows a more balanced penetration of international trade. In a word, the goal is to design development strategies geared to a vigorous external policy that would provide a broader scope for negotiation, complemented internally by strengthening of the national production plant to satisfy the needs of consumption, employment, and productive integration. It is also essential that such adaptation consider the possible generation of surpluses for export.

The potential implicit in an increase of intraregional trade was underscored as a factor of endogenous development. It was also pointed out that food self-sufficiency was a priority policy that did not necessarily imply isolation of production within the national borders. Account must also be taken of the many restrictions, both tariff and nontariff, that affect intraregional trade. At any rate, the rallying cry remains the same: aim at heightened trade in agricultural and livestock commodities within the Latin American region.

As to the concept of adjustment combined with growth in agriculture, it was suggested that in addition to providing more elbow room for external negotiation, a complement should be to strengthen the nation's production plant by adapting it in such a way as to attain the levels of productivity and competitiveness necessary to meet national demands of consumption, employment and productive integration. The adaptation process must perforce include provision for the generation of surpluses that can be exported.

Emphasis was placed on the need for far-reaching change in the present strategies of the agriculture and livestock sectors in many countries of the region to provide them with an international and macroeconomic overview that would transcend the traditional narrow confines, both local and sectoral, in the

analysis of their problems and the search for solutions. To this end, the following policies were advocated:

- a. In the area of trade, to make national consumption objectives compatible with those for the generation of foreign exchange; to rationalize effective protection of domestic production to promote its expansion and efficiency; and to program the potential opportunities for exportable supply.
- b. In the monetary and fiscal fields: to replace the orthodoxy that has proven to be recessive with creative capacity and flexibility; for example, to substitute programmed and selective public spending for drastic cuts, financial intermediation aimed at development for a speculative banking system, and rationalization policies to preserve development strategies, for subsidies to parastatals.
- c. Sectoral allocation of resources, suppression of the predominance of financial criteria in determining the amount and distribution of public spending guided by the criteria of development and structural change.

It was pointed out that in order to achieve adjustment combined with growth in agriculture, we must realize that the nature of this activity is such that a lack of flexibility characterizes agricultural enterprises, which require careful consideration of the time factor, types of farmers, and a new role for the state in the adjustment process. It was argued that the margins of flexibility would be considerably widened if agriculture were considered to be a stage in an agroindustrial complex.

Growth has played a very positive role in experiences with adjustment policies, both in industries that have flourished under the aegis of the import substitution policy and in agricultural industrialization processes based on products earmarked for export. It could nevertheless happen, on certain occasions, that a process for expanded productivity might make the process of economic stabilization virtually impossible.

One of the chief determinant features of adjustment policies is that their implementation must be accompanied by excessively high real interest rates. This fact tends to distort any allocation of resources and ends up, within the countries, in transfers of income that can become politically untenable and inauspicious to the agricultural sector of tradeable goods. This situation might be diagnosed as adjustment policy fatigue.

On the other hand, it must be made clear that adjustment policies have to be functionally linked with those of debt renegotiation. There is also an external determinant: adjustment with growth cannot be achieved if the present adjustment policies of the developed countries are to continue.

A very complex undertaking --which in many cases does not work-- consists of devising a way to replace the mechanisms that subsidize farm credit: in other words, a means of transferring resources from the non-agricultural sector to the agricultural sector, particularly in the face of such high real interest rates.

High interest rates, it was pointed out, were due in part to the external transfers of Latin American resources, since interest rates inevitably climb when funds for lending are curtailed. Once again, this betokens the linkage between adjustment policies and those for debt renegotiation.

In the international context, emphasis was placed on the virtually autonomous growth of the financial variable, independently of the real situation obtaining for the developed countries themselves. That factor implies a monumental challenge; but --and this must be borne in mind-- at the same time it impairs the freedom to make decisions.

Caution was also expressed against placing exaggerated emphasis on export requirements. The aim is to heighten growth, for which the crucial factor is economic expansion. This entails an increase in imports. Accordingly, exports are necessary as a healthier means of financing those import requirements.

Latin American countries face a very serious challenge in future years, particularly in the selection of investments and development options in a financial world that operates with great autonomy. On the other hand, the challenge also involves world trade that changes with technological speed, in which it does not seem expedient to concentrate exclusively on products involving simple technology to take advantage of Latin America's natural resources: flowers, fruit, shellfish... Neither is it easy to carry out highly flexible strategies in the agricultural sector. Perhaps the flexibility could be channeled to agro-industrial development and the services incorporated in agricultural and livestock tradables.

B. DISCUSSION DOCUMENTS

Agricultural Policies in Developing Countries: National and International Aspects 1/Introduction and objectives

Agriculture still accounts for a large share of income, employment and foreign exchange earnings in developing countries --especially in the poorest ones. While its share in national income has declined significantly since the 1960s, policies that bear on agriculture will remain critically important to economic growth in developing countries for decades to come. At stake is the future of the hundreds of millions of very poor people who live primarily in rural areas. Because of this, agricultural policy issues lie at the heart of the development process, and continue to be intensely debated and discussed in both international and national forums.

One of the popular themes in the discussions on agriculture has been the capacity of developing countries to expand the production of food in step with, or exceeding, population growth. Traditional concerns about the trends in food availability in developing countries were reinforced by a series of food crises, starting with poor harvests in East Pakistan and India in the 1960s. Still more dramatic was the "global food crisis" of 1972-74. Although it was the result of an unfortunate coincidence of various events, this episode was seen by many as the beginning of a long-term trend toward global food shortages. The subsequent food crises and famines in several parts of the developing world strengthened the Malthusian pessimism that prevailed during the 1970s. The report of the Club of Rome, for example, raised the serious possibility of a Malthusian doomsday at the turn of the next century.

At the aggregate level, these concerns were wrongly conceived. The most remarkable phenomenon at the global level is the long-term decline in the real prices of such important food grains as rice, wheat, and maize. Thanks to technological progress, the real cost of producing food has been declining. There is no reason to presume that there is a break in that trend, especially since rapid technological progress has taken root in many developing countries. With the emphasis that governments in developing countries have continued to give to research and extension programs, new technological breakthroughs are quite likely. While there is much to be done, especially in Africa, at least there is no doubt as to the priorities in this area.

1/ Document presented by Dr. Anandarup Ray, World Bank Economist. An original version was presented at the Nomisma International Conference (Boloña, Italy, Sept. 1986). The autor thanks Ajay Chhibber, Guy Pfefferman and Ernest Stern for their comments; though this document is based mainly on themes contained in the World Bank Report on World Development 1986, the author assumes full and exclusive responsibility for its content.

But growth in food production does not, of course, have all that much to do with food security --that is, with the prevention of famines or the alleviation of chronic malnutrition. Famines and malnutrition coexist globally with food surpluses of the OECD countries; even within developing countries, the attainment of surplus food stocks do not necessarily do much for the most deprived groups. Consequently, food security has become the prominent theme in recent years. In most cases --although not always-- this has led to emphasis on shorter term distribution issues and on such special remedial actions as increases in food aid, early warning systems for famines, and a variety of initiatives that governments in developing countries can take to help the groups which are most vulnerable from the nutrition standpoint.

While this is a useful way of approaching the issues, this is not the only perspective from which they can be examined. Approaches that emphasize the production side or the short-term food distribution issues do not lead immediately to some of the most important questions in world agriculture today, namely, what are the typical agricultural policies of developing countries? Are they efficient? How well do they serve the objectives of economic growth, the elimination of hunger and the alleviation of poverty? How do these countries' agricultural policies and those of industrial countries affect each other? Even if the external environment facing developing countries is a difficult one, are they making the most of it or are they making matters worse through domestic policy mistakes? If agricultural trade and domestic policies were liberalized throughout the world, could one expect substantial gains for the world economy in general and for developing countries in particular? 1/.

The purpose of this paper is to provide a broad and indicative review of the policy trends in agriculture in developing countries. This review is intended to explain why these questions are important and deserve more systematic attention than they have thus far received.

The policy paradigm in developing countries

There are very important public goods which only governments can and do provide to support agriculture in developing countries: for example, large-scale irrigation, flood control, research and extension, rural roads, and other infrastructure. The fact that public spending on these types of services can be extremely helpful has been amply demonstrated in many cases. For example, expansions in irrigated areas and the development of new varieties of wheat and rice have been major factors behind the growth of agricultural production in Asia and South America --two regions in which per capita food production has easily exceed population growth during the last fifteen years. No agricultural strategy is likely to succeed in any country without a major effort by the government to provide the types of public goods mentioned above.

1/ In developing this perspective I was influenced by Johnson, 1973.

Yet, the provision of essential public services to promote agriculture is but one of many elements of economic policy that determines growth in agriculture. Without a sound policy environment, much of the scarce resources spent on such services can be wasted. Thus, while large irrigation capacities have been created in countries such as Mexico and India, an embarrassingly large share of it is underutilized, poorly maintained, or written off --so much so that rehabilitation of existing works, rather than creation of new ones, has increasingly become the top priority in this area. With respect to technology, the problem in many parts of the world is to induce farmers to adopt proven techniques rather than to create new ones. And the policy errors that governments make have a tendency to misallocate not only private investments but also public ones, since governments are often influenced by market signals in choosing priorities for crop development or in identifying bottlenecks and scarcities of various types. In Egypt, for example, land reclamation projects are given high priority even though they are frequently uneconomic. A major reason why such projects seem attractive at first sight stems from subsidies given to the livestock sector which unfortunately only exacerbate the scarcity of land.

The main elements of the policy environment that one must examine are: a) general development strategies and macroeconomic policies; b) taxation of farm outputs and farm input subsidy programs; c) special public interventions in marketing.

Logically, these elements are unseparable because what matters ultimately is the profitability of farming in relation to that of other activities. Generally speaking, all prices are relevant to farm profits. Even user or access costs of publicly provided services can be included as price variables, so that it is wrong to ignore "variables" unrelated to "prices".

Economic strategies and macroeconomic policies

The recurrent debt crises, episodes of high inflation and macroeconomic instability and fluctuations in oil and other commodity prices have all combined to produce turbulence in the world economy during the last fifteen years. This has brought to the forefront the question of how economies adjust and how domestic policies of various types inhibit or facilitate that adjustment. The traditional way of looking at sectoral policies in a slowly changing long-term planning framework is no longer quite appropriate since agriculture is a very important part of the trade sector. Policies that bear on it have a crucial role to play, even in the short run.

This experience has placed new demands for flexibility and adaptability in policymaking and has highlighted the linkages between economy-wide and sectoral policies. Perhaps the most important mechanism through which economy-wide policies affect agriculture is the real exchange rate, on which a great deal of attention has recently been placed.

There are several different ways in which the concept of the real exchange rate is used in practice. One way is to define the real exchange rate for a country as the price in its own currency --deflated by its own general price index (P) --of an international basket of goods deflated by the international index of inflation (P*). If the nominal exchange rate is E, then the real exchange rate is defined as 1/:

$$\text{RER} = E \cdot P^*/P$$

This is the way the concept is most often defined in empirical measurements, even then what we really want to measure is the price of tradable goods relative to the price of nontradables. Adjustments of the real exchange rate typically involve changes in the relative prices of these two types of goods. For example, a depreciation entails a switch of resources to the tradable goods sector. Under flexible exchange rates, such adjustments should ideally take place by movements in the nominal rate that equally affect the prices of all tradable goods. Under flexible exchange rates, such adjustments should ideally take place by movements in the nominal rate that equally affect the prices of all tradable goods. Under fixed exchange rates --with tradable prices determined by world markets-- adjustments should take place through movements of the internal price level of nontradables. Since a major factor in the behavior of the latter price level is the behavior of the wage level, often the adjustment process can be thought of as one involving changes in the real product wages (measured in terms of tradables).

In practice, of course, the prices of traded goods do not move together. Commercial policies, as reflected in taxes on exports and tariffs on imports, have a strong bearing. On the basis of the influential paper by Sjaastad and Rodríguez, a measure of the exchange rate overvaluation can be obtained as 2/:

$$\log(e^*/e) = (1-w)\log(1-t) + w\log(1+t)$$

where t and t are average tax rates on exports and imports, e^* is the real exchange rate when t and t are zero, and e is the real exchange rate under the actual trade policy.

This focus on trade policy is important because it brings out that the real exchange rate can be highly overvalued, due to the import barriers entailed in inward-looking --or "development-through-protected-industrialization"--

1/ See Harberger, 1986

2/ See Valdés, 1985 and Cavallo, 1985.

economic strategies pursued in many developing countries. Overvaluation of the real exchange rate hurts agriculture because agricultural import-substitutes and exports typically receive little support relative to industrial products.

But the influence of trade policy does not work merely through relative output prices. Producing agricultural inputs inefficiently under tariff barriers also hurt agriculture, unless domestic input subsidies are provided. Moreover, as the above equation shows, the inward-looking trade strategies makes the real exchange rate lower (i.e. appreciates it) relative to what it would be otherwise. Thus, nontradables become more profitable than tradables. While this is compensated for in the case of industrial products due to high tariffs (in the case of binding quotas, those products become nontradables), agriculture suffers doubly --relative to industry and relative to nontradables.

Several studies have shown how protectionist policies for industry affect the prices of agricultural products relative to the prices of protected industrial products and of nontraded goods. In the Philippines, from 1950 to 1980, heavy protection to industrial consumer goods meant that prices of agricultural exports were lower by between 44 and 71 percent (depending on various categories of imports) relative to the prices of protected traded foods, and were 33-35 percent lower relative to the prices of nontradable goods. In Peru, a 10 percent increase in tariffs on nonagricultural importables was found to decrease the prices of traded agricultural goods by 10 percent relative to the prices of those importables, and by 5.6 to 6.6 percent relative to the prices of nontradables. Similar results have been obtained from countries as varied as Argentina, Chile, Colombia, Nigeria, and Zaire.

But government policies affect the real exchange rate not only through commercial policy; changes in fiscal, monetary, and exchange rate policies are also important. If the government has a higher propensity to spend on nontraded goods, then increases in these expenses will tend to appreciate the real exchange rate. Similarly, if a government finances fiscal deficits by inflationary measures but does not depreciate the nominal exchange rate correspondingly, then the real exchange rate will appreciate. The same happens if a government finances its deficits by foreign borrowing 1/.

In practice, all these factors have often worked together. For example, when expansionary monetary and fiscal policies have led to higher inflation at home than abroad, governments have often increased protection to industry, rather than change the official exchange rate. Various devices, such as quotas, exchange controls and licensing have been used. These typically

1/ See Cavallo, 1985.

favor domestic industry. Food imports are typically excluded in order to keep urban food prices low: in other words, food imports are implicitly subsidized. Furthermore, in trying to reduce fiscal deficits in such situations, countries often raise export taxes on agriculture, thus exacerbating the bias against agriculture.

As another example, macroeconomic mismanagement can cause severe problems in the face of capital inflows from abroad or sharp increases in the world prices of key exports. A favorable change in the external terms of trade should, of course, appreciate the real exchange rate, other things being equal. In itself such a phenomenon --underlying the so-called "Dutch syndrome" problem-- is not an issue in economic resource allocation, unless the short-term switches from traded to nontraded sectors have long-term costs (due, for example, to the partial irreversibility of factor movements). But, faced with favorable terms of trade, a country can also liberalize its import regime, thus nullifying the exchange rate appreciation. This happened in Iraq in the late 1960s and early 1970s ^{1/}. But time and again, governments have regarded temporary bonanzas as permanent, and have escalated their commitments to unsustainable domestic programs, causing the real exchange rate appreciation to increase acutely during the boom period, and allowing it to continue afterwards. This happened in Colombia, for example in the case of coffee. Nigeria and Venezuela also reacted improperly to the oil price increases of the 1970s. This type of problem is liable to happen in all countries, especially in the smaller ones that are highly dependent on exports of a few primary goods.

In assessing agricultural performance therefore it is of great importance to examine commercial and macroeconomic policies and how they have implicitly hurt or helped agriculture. During the 1970s and early 1980s, the real exchange rate was allowed to appreciate sharply in many countries. On a regional basis, the appreciation was sharpest in the countries of sub-Saharan Africa --the region which suffered the worst experience in agriculture during this period. Table 1 based on the 1969-71 period shows one measure of how much real exchange rates moved in selected African countries.

When real exchange rates appreciate so sharply, their effects can counteract the effects of policies more specific to the sector, which are often adopted independently from economy-wide developments. Since in sub-Saharan Africa --as in many parts of developing countries-- the cost of modern farm inputs imported or produced at home is only a small fraction of total farm costs, the importance of real exchange rate appreciations relative to sectoral policies can be seen by looking at trends in farm output prices. Insofar as real labor costs increased due to the migration of farm labor, the adverse effects of macroeconomic policies would have been greater than indicated by output price trends alone.

1/ See Harberger, 1986.

Table 1 Index of real exchange rates in selected African countries (1969-71=100)

Country	1973-75	1978-80	1981-83
Cameroon	75	58	80
Cote d'Ivoire	81	56	74
Ethiopia	93	64	67
Ghana	89	23	8
Kenya	88	69	86
Malawi	94	85	94
Mali	68	50	66
Niger	80	56	74
Nigeria	76	43	41
Senegal	71	60	85
Sierra Leone	100	90	73
Sudan	76	58	74
Tanzania	85	69	71
Zambia	90	79	86
All sub-Saharan Africa	84	62	69

Note: A decline in the index reflects appreciation

Source: World Development Report, 1986.

The trends shown in Table 2 show how real farm incentives eroded over time in sub-Saharan Africa despite apparent improvements in nominal terms. Using official exchange rates, one would infer that incentives for cereal production in Africa increased by 51 percent between 1969-71 and 1981-83, that is to say, domestic prices increased significantly more than border prices.

But if border prices were calculated by taking into account the real appreciations, the actual increase in incentives would be only 9 percent. For export crops, incentives increased nominally by about 2 percent; in fact however, they declined sharply --by 27 percent.

This is not all. Policymakers in all countries frequently cite the variability of world prices of agricultural commodities as a reason for reducing reliance on trade and on private markets, and for undertaking various types of public interventions aimed at making domestic prices more stable. But it is not necessarily the variability of domestic prices of traded goods at official exchange rates that matter. Fluctuations in real exchange rates can greatly exacerbate the variability of real farm incomes.

Table 2 Index of nominal and real protection coefficients for cereals and export crops in selected African countries, 1972-83

Country	Cereals				Export crops			
	1972-83		1981-83		1972-83		1981-83	
	Nominal Index	Real Index	Nominal Index	Real Index	Nominal Index	Real Index	Nominal Index	Real Index
Cameroon	129	90	140	108	83	61	95	75
Cote d'Ivoire	140	98	119	87	92	66	99	71
Ethiopia	73	55	73	49	88	71	101	66
Kenya	115	94	115	98	101	83	98	84
Malawi	85	79	106	100	102	94	106	97
Mali	128	79	177	122	101	83	98	70
Niger	170	119	225	166	82	59	113	84
Nigeria	126	66	160	66	108	60	149	63
Senegal	109	79	104	89	83	60	75	64
Sierra Leone	104	95	184	143	101	93	92	68
Sudan	174	119	229	164	90	63	105	75
Tanzania	127	88	188	95	86	62	103	52
Zambia	107	93	146	125	97	84	93	80
All sub-Saharan Africa	122	89	151	109	93	71	102	73

Note: The nominal index measures the change in the nominal protection coefficient with border prices converted into local currency at official exchange rates. The real index measures the change in the nominal protection coefficient with border prices converted into local currency at real exchange rates.

Source: World Development Report, 1986.

Table 3 shows the range of variation of the real exchange rate in selected countries, using the ratio of the maximum rate during the period to the minimum rate as an index 1/. As a result of these variations, the actual incentives received by farmers were highly unstable --especially in Chile, Argentina, Bolivia, Costa Rica, Ghana, Zaire, Nigeria, Uganda, and Pakistan. Crude as such measurements are, they once again emphasize the need to examine agricultural policies in an integrated framework and highlight the inadequacy of purely sectoral analysis.

Table 3 Range of variation of the real exchange rate
(Maximum rate in period - minimum rate)

	1970-83
Argentina	2.68
Bolivia	2.00
Chile	5.90
Costa Rica	2.42
Ghana	12.89
Nigeria	2.34
Uganda	4.62
Zaire	2.90
Egypt	1.98
Indonesia	1.71
Pakistan	2.11

Source: Harberger (1986)

The importance of real exchange rate movements for agricultural production and exports has been illustrated in terms of straight-forward analysis. For example, a look at the charts in Figure 1 would suggest that a close relationship exists. A more systematic review however shows that an average percentage point fall in the real exchange rate reduces agricultural exports by 0.6 to 0.8 percentage points in developing countries, and by over one percentage point in sub-Saharan Africa 2/. To be convincing, however, it is necessary to simulate the major interactions between macroeconomic and sectoral policies, taking explicit note of the sectoral policies. This will be shown in the following analysis.

1/ See Harberger, 1986.

2/ See Balassa, 1986.

Sectoral policies

Perhaps the most perceptive account of sectoral policies in recent years is that by Robert Bates (1981). The paradigm he develops for some African countries is basically extendable to other developing countries, with the clear exception of those few that have grown very rapidly since the 1960s and now emulate the policies of industrial countries --for example, Korea and Taiwan.

According to this paradigm, a developing country typically runs a large program of food subsidies in urban areas. Producer output prices are usually suppressed relative to border prices even at nominal exchange rates. Producers do receive subsidies on production, especially through low-interest credit, but such subsidies benefit mostly the relatively affluent modern farmers. Furthermore, the government intervenes throughout the whole process of production, processing and consumption. All too often, private markets are not trusted --for reasons best described by Adam Smith a long time ago and more recently by Peter Bauer. Marketing parastatals, with monopoly buying and selling privileges exist in numerous countries, including in Africa where their role has traditionally been most emphasized.

There is considerable uncertainty as to the precise amount by which agricultural goods are taxed but they are undoubtedly large. In all countries, the link between the prices of imports or exports at the border and the prices at the farmgate are quite complex, and the forms of taxation and subsidies actually used in practice vary greatly. Quite apart from import tariffs and export taxes, there are trade quotas. Frequently, the amounts to be traded, as well as farmgate and urban prices, are decided by government agencies with monopoly trading powers. Their decisions can operate much like quotas or trade taxes. And it is not just agricultural decisions that matter. Transport regulations, trucking monopolies, exchange regulations and licensing issued by other agencies, etc., all contribute to the divergence between domestic farmgate and border prices.

Since few countries regularly monitor the farm-border price relationships, the "de facto" taxes and subsidies that affect farmers need to be researched. This is not a simple undertaking since the price relationships are typically unstable within and between years. Nonetheless, a great deal of work has been done in this area, for example by Binswanger and Scandizzo (1983). Analysis of this type is also undertaken routinely by the World Bank through its sector and economic work. As a result, a large amount of evidence has been accumulated for many countries, commodities and time periods 1/.

1/ This evidence is typically available in terms of nominal protection coefficients. But effective protection rates, when available, do not alter results because, at the margin, most types of farming in developing countries do not use much purchased inputs.

On the basis of this evidence, some of which are reproduced in the "World Development Report 1986", it is clear that developing countries typically tax their traded agricultural products, quite independently of the indirect effects of the preferential protection to industry and the overvaluation of the exchange rate. Thus, sectoral policies exacerbate the anti-agriculture bias implicit in economy-wide policies.

Export crops are typically taxed. This has come to be expected in the case of raw materials and beverages, either for revenue reasons or for exploiting alleged monopoly powers in world markets. What is surprising, however, is that export taxes are often very high --of the order of 50-75 percent. The situation is somewhat mixed in the case of agricultural import-substitutes. Some developing countries --especially middle-income ones-- have indeed tried to give preferential treatment to domestic production over imports in the case of a few food products --especially wheat, dairy and meat. Wheat, in particular, is a crop that many try to support. But, this support has not been very high and has often been offset by the effects of macroeconomic policies. Generally speaking, keeping domestic prices higher than border prices still remains an infrequent policy in developing countries.

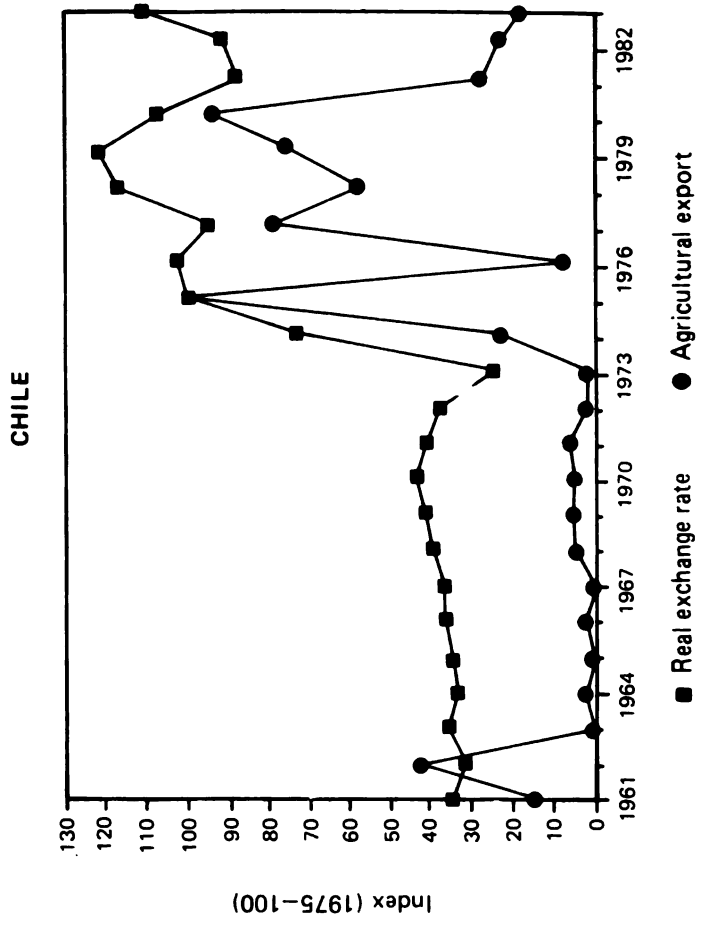
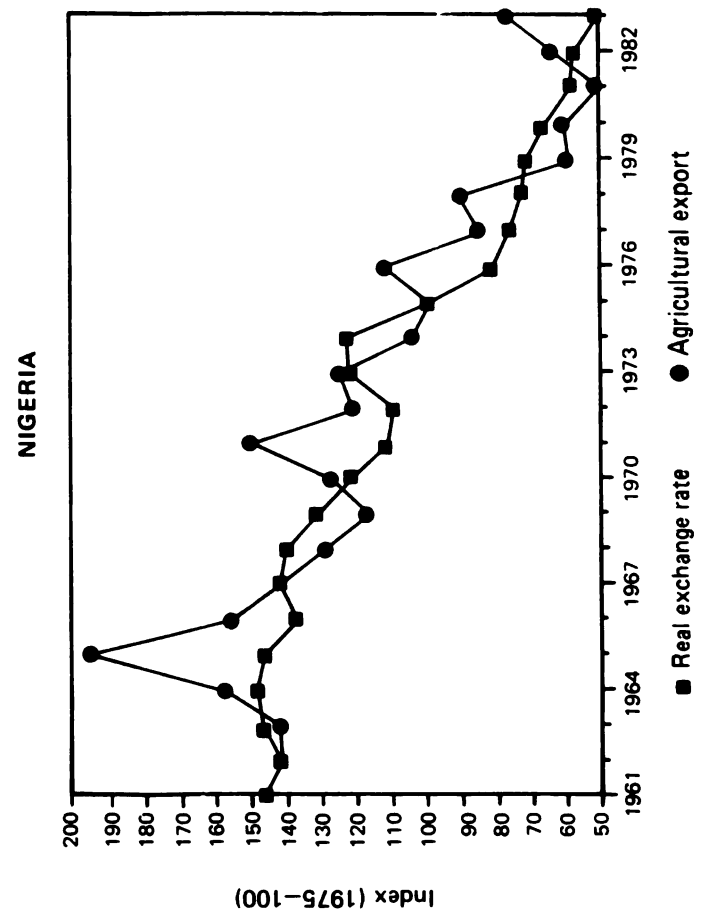
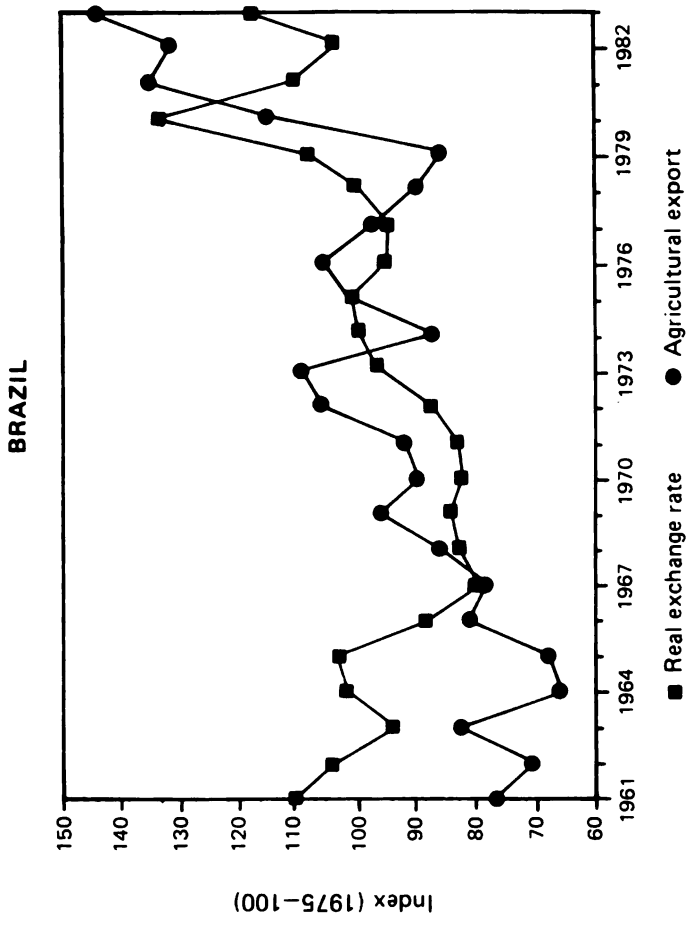
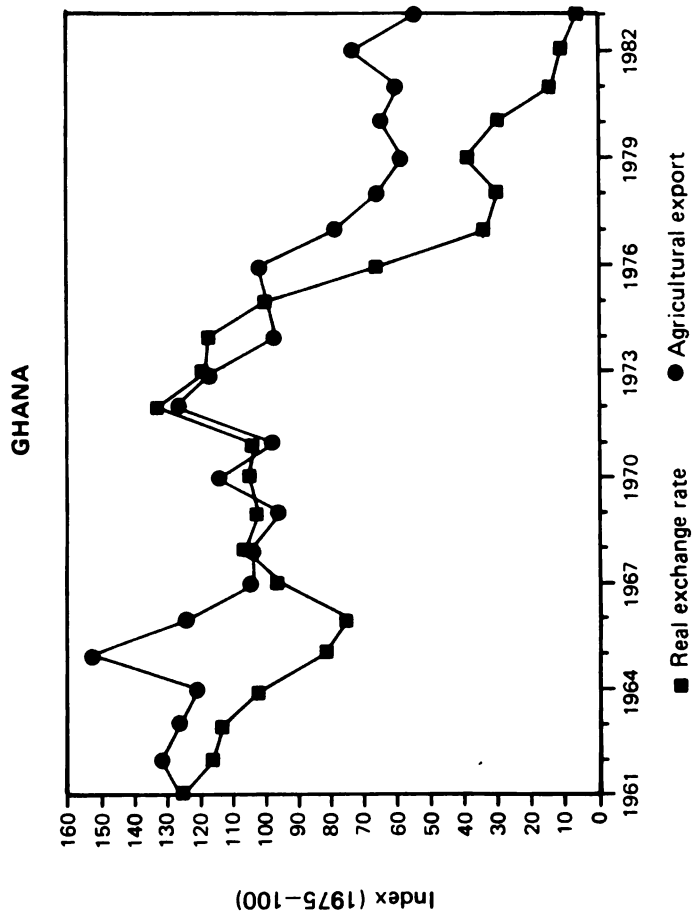
It is much more common to subsidize imports by procuring domestic food grains below border parity prices. Monopoly trading powers in internal and external markets make this feasible. This type of a policy has been particularly noticeable in Africa: for example in Ethiopia, Ghana, and Tanzania. Rates of taxation of domestic producers have again tended to be excessive --of the same order of magnitude as export taxes.

It is true that the exercise of monopoly powers is much more difficult in the case of food crops. Parallel markets and illegal cross-border trade flourish in Africa despite various attempts and policing. Nonetheless, the growth of parallel markets only indicates that some farmers can escape the very high rates of taxation that they otherwise would have to pay.

They do not escape the tax entirely (although it is difficult to know just at what rate of taxation would they have been indifferent to selling on the official or through parallel markets). It is also true that by forcing farmers to sell elsewhere governments defeat their purpose, which is to procure food at low cost for subsidizing distribution in urban areas. The end result is reliance on higher cost imports and higher foreign exchange and budgetary losses.

On the input side, the available evidence is more difficult to digest. In the case of factor inputs, the economy-wide policies and currency overvaluations tend to increase returns and wages in urban areas, relative to those in rural areas, and this hurts farming and creates excessive migration. In the case of inputs such as fertilizers, seeds, pesticides and machinery, the typical policy is to distribute them to farmers through public agencies and at highly subsidized prices relative to border prices. The prices that farmers actually pay, however, are not necessarily those which are nominally charged by public agencies. Subsidies do not alleviate shortages, and the market-clearing

Figure 1. Indices of real exchange rates and agricultural exports in Ghana, Nigeria, Brazil and Chile, 1961-83.



prices can exceed border prices. This is especially so if account is taken of the frequently poor quality of the marketing services that public agencies provide.

This is also the case with rural credit, which has been provided at very low interest ceilings in many countries, especially in South America. Negative real interest rates of the order of 40 percent or so have been known. This policy leads to rationed markets and to various types of secondary markets: the rich have access to them and land values increase fast. The actual cost of obtaining credit is difficult to measure in such a system since the coupon rate is just one aspect of the operation. As is well-known, the actual cost of credit also depends on repayments and default. The government does not determine the cost of credit simply by adjusting nominal rates.

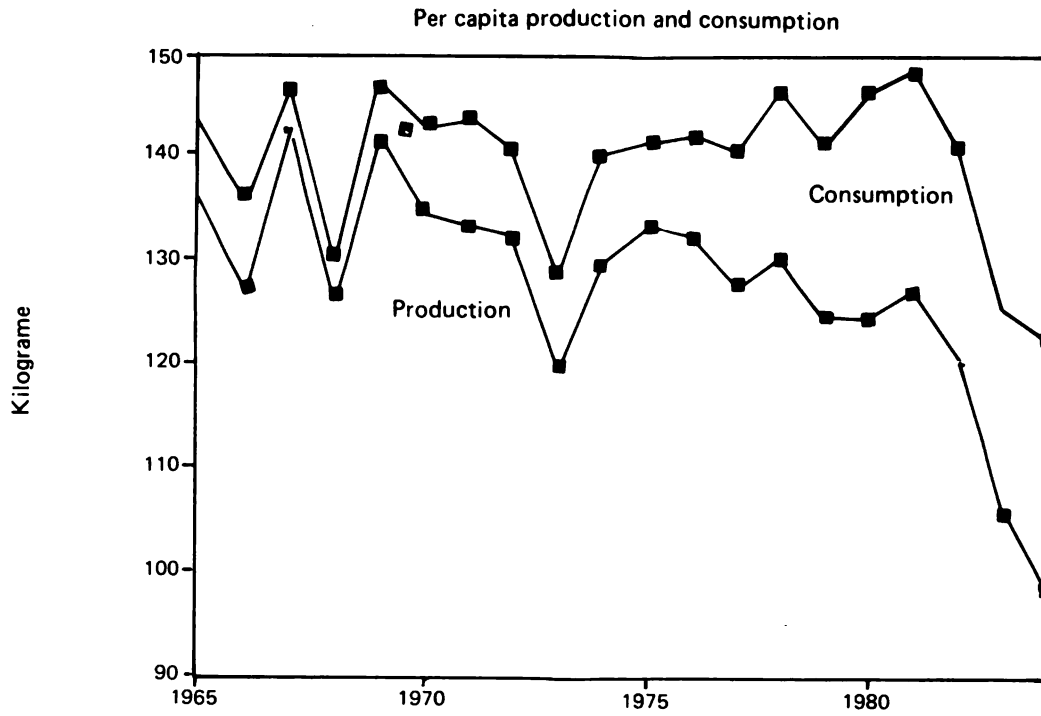
There is little basis for hoping that public input supply programs --on which large amounts of resources are often spent-- will compensate farmers for the discrimination they suffer on the product side. In fact, the long-term impact of subsidized input supply programs is often the opposite of what one hopes for. Tying up large amounts of resources on current expenditures means less resources are available for expanding the capacity to provide inputs. Even in the case of credit, if the subsidies are large and real interest rates negative, it becomes difficult to sustain rural credit programs without creating inflation. The credit programs in Brazil, for example, have contributed significantly to its high rates of inflation. Inevitably this type of policy leads to curtailment of credit programs during economic stabilization. If one looks at the real volume of credit available to farmers, one finds that in Brazil it has been declining sharply. As this case illustrates, subsidized input supply programs can reduce the availability of inputs in the long run.

Issues in taxation and subsidies

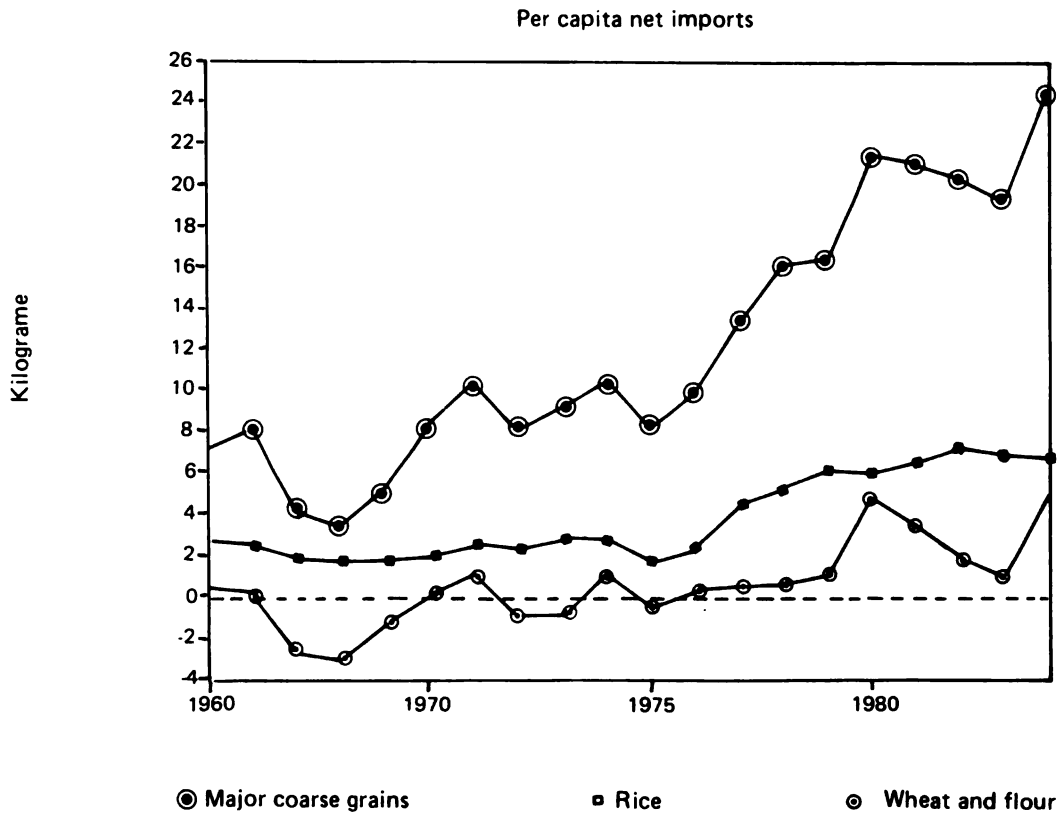
This review of sector policies suggests that agricultural development has been strongly discriminated against in developing countries. The mainstream discussions of agriculture in international forums, which have led to such valuable initiatives as those on agricultural research and early-warning systems for famines, and which have rightfully drawn our attention to widespread acute poverty, have neglected to emphasize the importance of discriminatory policies that developing countries have often pursued systematically. The world they face is a bad one indeed --I shall discuss this in the next section-- but their own policies have compounded the problem. This is the basic paradox that one should not lose sight of.

As seen earlier, the character of the overall development strategy that a developing country follows is extremely important. Inward-looking strategies that promote inefficient industrialization not only fail to succeed in bringing about a competitive industrial base --as the research done by Balassa, Bhagwati, Krueger and others have amply demonstrated-- but they also inhibit the growth of the agricultural sector where poverty is often concentrated. What is needed is a trade-neutral or bias-free strategy. There should not be any bias against exports, i.e. the effective exchange rate for a

Figure 2. Production, consumption and imports of cereals in sub-Saharan Africa, 1965-84.



NOTE: Consumption is calculated as production minus net trade.



country's exports should equal the effective exchange rate for its imports ^{1/}. The bias against exports is a prime cause of the bias against agriculture. Even within imports, non-agricultural import substitutes tend to be favored relative to agricultural import substitutes. This exacerbates the bias against agriculture.

In terms of policy priorities, it is clearly important to allow exchange rates to adjust fully and quickly to differential rates of inflation at home and abroad. But even if this policy were followed, the real exchange rate would still remain too high as long as import tariffs remain high. Exchange rate management is not a narrow concept that only deals with the movements of the official exchange rate. As discussed earlier, the real exchange rate concept deals with the whole trade regime. Dismounting the tariff and non-tariff barriers that are typically erected to favor industry would not only increase the efficiency of the industrial sector but also promote the efficiency and growth of the other sectors, including agriculture.

It has been argued, however, that taxation of agriculture --whether implicitly through macroeconomic policies or explicitly through sector-specific taxes-- is needed for a variety of reasons, of which the principal ones are the following: first, the need to obtain revenues, and there is no doubt that agriculture provides the largest tax base in many developing countries; second, the argument prevails that taxation of export crops, for which foreign demand lacks elasticity, is the appropriate means for capturing monopoly rents. Third, it is argued that agriculture is inherently unprofitable in the long run, and taxing it will provide for an industrial base, presumed to be the only means to sustained development, for which it is argued, not only are tax revenues required but also low urban wages. Finally, it is often thought that taxation of agricultural producers is needed to fight poverty by providing cheap food for both the urban and rural poor.

These types of arguments are typically based on certain long-standing premises that can be seriously questioned in the light of experience over the last few decades. First and foremost among these is the notion that agricultural production is not price responsive. Numerous studies have shown that crop supply elasticities can be quite high, even in low-income Africa. But even if a crop supply elasticity is low, this does not mean that taxing the product will have little efficiency effects. The real national income that is lost as a result of a tax, tends to increase more than proportionately to the tax rate. High marginal tax rates can have high efficiency costs, and at the same time generate less revenue than more moderate rates.

1/ See, for example, Bhagwati, 1986.

Moreover, sustained taxation at high rates can have far more serious effects than typically captured in studies on supply response. This comes out most strongly in the studies on Argentina and Chile carried out by the "International Food Policy Research Institute". In these studies, agriculture is defined in the aggregate, so that the implications bear on the controversy about aggregate supply response, which is expected to be lower than the supply response for any individual crop, due to cross-price effects.

The study on Argentina showed that between 1950 and 1972, if agricultural prices had been 10 percent higher than they in fact were (when the government was taxing them heavily), total agricultural output would have gradually increased to a level approximately 9 percent higher, on an annual basis, than it actually did over that period. The increase in production would have been achieved largely because more capital would have been attracted into agriculture, and technical improvements would have been promoted. Macroeconomic and sectoral policies combined to produce a large reduction in agricultural output. A similar simulation for the Chilean economy over the period 1960-82 indicated an even greater supply response: the level of output would have eventually become 20 percent higher each year than otherwise in response to a 10 percent sustained increase in the agricultural price. Sustained taxation of farming can thus lower the returns to investment, discourage technical progress, and encourage farmers to leave the land 1/.

While the evidence from Argentina and Chile may not be fully applicable to other countries, the results are intuitively very plausible and are in accordance with the general experience in other countries as well. Where discrimination against agriculture has been moderate --as in many Asian countries-- it has done well, and food production has easily outpaced population growth. In China --for example-- the dramatic turnaround in agriculture since the reforms began cannot be explained in terms of public expenditures on infrastructure and input supply programs; it can only be explained in terms of higher incentives to farmers due to better prices and significant moves in the direction of private property and marketing 2/. In contrast, sub-Saharan African countries, where agriculture was most discriminated against, performed dismally --as partially shown in Figure 2.

The fact that supply responses in agriculture can be high, points to the need for great caution in drawing policy conclusions from the conventional analysis of long-run trends. While it is true that the share of agriculture in the national income tends to decline over time as economic development proceeds, this does not imply that the process should be speeded up through excessive

1/ Cavallo and Mundlak, 1982, see also Mundlak, 1979.

2/ Lardy, 1985.

taxation. Inter-sectoral neutrality of economic policies would ensure that the decline in the relative share would occur at the right pace through natural technical progress.

The Prebisch-Singer thesis about declining barter terms of trade is another concept that has continued to linger in the public mind and influence policymakers, despite the detailed scrutiny it has received from Spraos and others. Whether that thesis was right or wrong, its basic problem was that it never had much to do with the policy priorities in any particular country. Indeed, as the experience of Malaysia and Thailand with palm oil and rubber has shown, primary production can survive as an economic proposition if technical change is encouraged.

The evolution of exports in world markets is a particularly relevant indicator in this context. It also suggests that the power of monopolies in world markets can be easily overestimated. Those countries which neglected their primary sectors and imposed heavy taxes --perhaps for the purpose of capturing monopoly rents in the world markets-- have seen their market shares rapidly dwindle --Ghana and Nigeria in cocoa, Nigeria and Zaire in palm oil, Burma in rice, Egypt in cotton and Sri Lanka in tea. It is not that one should not be concerned with declining trends in world prices, it's that there should be a better way of coping with the problems that these countries have had to face because of these trends.

At a deeper level there remains the question of trade-offs: the trade-off between sacrificing some national income through taxation to finance productive public expenditures, and the trade-off between efficiency and the relief of poverty. Regarding the first, it has become conventional in agricultural literature to pose the trade-off in terms of "price" versus "non-price" factors. However, this is an improperly formulated trade-off.

Apart from the artificiality of separating price and non-price factors, the topic is generally discussed in terms of total agricultural output, and not in terms of GDP or some other welfare measure, and even then the limitations of using trade-offs for analysis are seldom specified.

Perhaps the simplest way of putting the policy question would be to say that agricultural taxes are needed for raising revenue, which in turn is needed for financing desirable public expenditures --in particular in rural areas. One can then go on to show that the economy may benefit when farm products are taxed at a given rate. Such an analysis can be easily constructed to make a demonstration for some taxation of agricultural outputs is valid, in some cases. If land or income taxes are ruled out for political or administrative reasons, then it is possible that taxes on production may well be the only feasible way of raising revenue from agriculture. Export taxes on plantation crops can even be designed in a manner that is equivalent to income taxes. Moreover, the configuration of demand structures for farm products and agricultural inputs may be such as to call for a combination of output taxes and input subsidies to minimize the cost of collecting revenue. A large taxonomy of cases can be created along these lines.

But such theoretical concepts cannot justify the high marginal rates of non production taxes which in practice exceed the revenue-maximizing rates. Nor can widespread abuses of this type justify in some cases subsidies for inputs such as fertilizers. Moreover, the problem one often faces in practice is that taxes on farm products do not always generate revenue in the conventional sense, and governments are often overextended on the expenditure side. Losses of parastatals alone have amounted to 1 or 2 percent of the GDP in countries as diverse as Peru and Tanzania. If a formal trade-off analysis were done, it would no doubt show a strong case for much lower public expenditures of the type usually undertaken, as well as a strong case for lower taxes on farm products.

Turning to the question of trade-offs, as between equity and efficiency, both these aspects are of course of great importance and relevance. As is well-known from basic welfare economics, different initial endowments of assets will lead to different Pareto points, and one cannot choose between these points without incurring distributional judgements. Once a social valuation function is defined, one can work out a set of optimum prices to which one can refer for measuring distortions. However, there is no consensus on what the social valuation function ought to be, and the resultant indeterminacy inevitably clouds policy analysis and discussions. What really encourage welfare programs and policies in the final analysis is the strong political interest that tends to develop among various groups of beneficiaries.

It should not therefore be much of a surprise to find that many economic policies serve neither efficiency nor social goals. Taxing farmers heavily affects all farmers -large or small- but the "compensatory" input subsidies generally accrue to selected farmer groups --especially the relatively affluent ones. Providing nondiscriminatory subsidies to the urban population and financing them through farm taxes is another very common phenomenon that frequently fails to benefit the real poor, while inhibiting growth and efficiency.

The recent literature on poverty and food security has explored a large variety of interventions that can be considered for redressing malnutrition and famines 1/. As in the "World Development Report", the policy of providing indiscriminate urban food subsidies have generally been considered to be high cost and ineffective relative to alternative targeted schemes. The manner in which urban food subsidies are often provided --for example, by keeping urban food prices fixed in nominal terms-- can play havoc with the budget and the import bill.

1/ See, for example, World Bank, 1986b; Pinstруп-Andersen, 1985; and Sen, 1986.

There is little doubt that sustainable food subsidy programs would be much smaller and much better targeted than the kinds of programs in effect during much of the last few decades in countries such as Egypt, Mexico and Sri Lanka.

While it is extremely important to examine the cost-effectiveness of the ways in which governments try to meet social goals, this approach has its limitations. Since no one --in or outside a government-- readily agrees to what the social goals actually are, in practical and operational terms, it remains impossible to design socially oriented programs fully and in the light of well articulated priorities. It is also impossible to answer the basic question: how much resource should be spent on special programs for the poor and how should allocations vary in response to the varying circumstances within each country?

This question raises intertemporal issues. Consider the question of the distributional impact of farm output taxes. It is often argued that there are rural societies where the poor, who are net purchasers of food, will get hurt when food prices rise. This is true, but one should quickly add that this does not mean that whatever the level of rural food prices happens to be at a given moment it should not be regarded as a ceiling. But, more importantly, it is highly likely that the long-run negative effects of food price increases on net purchasers will be smaller than the immediate effects; the effects may well become positive as rural employment opportunities and labor demand grow. And the long-run may be quite short as the recent case of China illustrates.

If one adopts as a mental experiment the well-known utilitarian framework --then the intergenerational social discount rate can be considered-- as a first approximation --as the expected growth in per capita income growth $1/$. The lower this growth, the lower should the weight on current policies for this relief of poverty be. In countries where per capita income growth is expected to be very low, or even negative, growth-inducing policies should be given the highest priority. Only those socially oriented programs and policies which induce growth would fit into high-priority policy packages. The view that a country can attain food security "if and only if" the growth rate is satisfactory is not just plausible but also very relevant, given the dismal experience since 1970 of many countries in Africa and Latin America.

The concept of food security also encompasses famines. A great deal of research on famines has been undertaken in the last two years $2/$. Without minimizing the influence of adverse events, such as bad weather and wars, there is little doubt that the severity of many of the famines has had much to do with social and economic policies. In the Bengal famine of the early 1940s, for example, keeping urban food prices low while financing additional war-time

1/ See Ray, 1984.

2/ See Sen, 1981, 1986.

demand and restricting inter-provincial trade, led to a high inflation tax on landless laborers and other vulnerable groups. As Adam Smith concluded with reference to another Bengal famine a long time ago, and as amplified and extended by Sen recently, dealing with famines is not just a matter of prompt curative steps, nor is it merely a question of aggregate food availability. Bad economic policies, and sustained far output taxation in particular, increase a country's vulnerability to famines.

Does all this imply that developing countries ought to be subsidizing their agriculture rather than taxing them? Should they introduce farm output price support schemes of the kind used in developed countries and in Korea and Taiwan? Although cases in which developing countries systematically maintain domestic prices above border prices are relatively rare, these questions are increasingly becoming relevant. Excess stocks in grains have emerged in many countries in recent years, e.g. in India, Indonesia, Malawi, Kenya and Zambia.

To the extent that support policies are intended to offset the anti-agriculture bias inherent in inward-looking strategies, they do have some plausibility. At the same time policy distortions are best attacked at their source. If inward-looking strategies are inappropriate and counter-productive, then the best policy by far is to give them up, rather than, try to improve things by introducing compensatory distortions in agriculture.

Besides, it is important to distinguish between policies that affect all of the tradable sector in agriculture and policies that affect individual crops. It would be easy to show that the huge subsidies implicit in the current Indian wheat policies are not justified on economic or social grounds. The current debates on the manner in which India should dispose of its enormous surplus stocks of wheat --produced at more than twice the border price-- tend to focus on options such as dumping abroad or special distribution schemes for the poor at home. But whether India provides food aid abroad (as has happened) or at home, it could no doubt do so at a lesser cost in terms of foregone national income. As in developed countries, it is hard to see how food security can be improved by throwing away scarce resources.

Finally, I must note that throughout the developing world the types of issues I have raised above are under serious re-examination and many countries have instituted very significant policy reforms. The broader the reform the better. Turkey, for example, has already achieved great benefits from its relatively recent reforms of both economy-wide and agricultural policies. But the importance of many micro reforms should not be underestimated --the changes in cotton pricing policies in the Sudan or the wholesale revamping of the food distribution system in Mexico, or the moderation of the food subsidy program in Sri Lanka, or the privatization of many parastatals that is underway in many countries.

International aspects

In many ways the policies in industrial market economies are the opposite of those in developing countries. They strongly support their farmers by keeping farm prices much higher than they would be in a free trade situation. New Zealand is the only exception, although similar farm support policies are also quite moderate in Australia. On average, internal producer prices in industrial countries are about 40 percent above comparable world prices. Moreover, the excess of domestic prices over world prices has grown very fast since the early 1960s, particularly in the EC and Japan, and also in Korea and Taiwan. Sustained support of farmers have led to growth in both outputs and yields. The EC, for example, has been transformed into a large exporter of grains and sugar since the initiation of CAP.

The types of intervention used to achieve high domestic price levels vary by country and by commodity. Producers of imported commodities, such as sugar, are protected by means of tariffs, quotas, or variable levies. If domestic protection creates excess supplies, the excess is disposed of on the world market through subsidized sales or as food aid. Several countries control output acreage as a way of keeping surpluses down. In addition, state-controlled marketing boards, direct payments to producers, and subsidies on inputs and credit are widely used to aid farmers.

The cost of farm support policies is enormous. Estimates of the cost vary, depending on the particular year considered and the assumptions made about what would happen in the absence of intervention, but are in the neighborhood of \$100 billion annually for consumers and taxpayers in the industrial countries. This is the estimated gain that would occur from lower consumer prices and government outlay if the industrial countries put an end to intervention in agricultural markets.

Farmers would lose from such a step, but not nearly as much as consumers and taxpayers would gain. Moreover, the gains that farmers receive now are mostly capitalized into asset values, primarily of land, so that for new farmers protection becomes a cost of entry rather than a benefit. Policies to protect farmers have also become less necessary as farming has become more and more a part-time occupation. In the United States, net farm income as a proportion of farmers' total income fell from 58 percent in 1960 to 36 percent in 1982. In Japan, where small-scale farming is dominant, farm households derived 75 percent of their income from nonfarm sources in 1980.

But the point is not the high cost of the support programs in absolute terms. The countries concerned are rich enough to afford high costs. Rather, the question is what objectives are being served by such wasteful policies. The most commonly cited objective is perhaps "strategic" food security --the ability to do without food imports in times of global crises. But given the long-term trend decline in food prices, since Malthusian times, there is serious doubt as to the desirability of maintaining an inefficient system permanently on the odd chance of a bad year. And in the event of such a year, the system can soon get disrupted by problems with access to the modern inputs on which agriculture in

the industrial countries so heavily depends. Paradoxically, the country which seems least concerned with strategic food security in this sense is the USSR, which has become a large importer in order to meet its rising consumer demand at subsidized prices.

But quite apart from the domestic costs, the international consequences of their policies are also of serious concern. Given the pattern of policies in developed and developing countries described above, it is obvious that the world as a whole does not maximize real incomes through its agricultural policies. Production is uneconomic at the margin in industrial countries. Their production and exports are too high, and their imports too low. This will still be so if developing countries remove discriminatory policies against their own agriculture. With free trade and better domestic policies one would intuitively expect very big gains to many developing countries --for example, to the major South American countries like Argentina, Brazil, Chile, Colombia, and Mexico, to the small sugar-dependent economies, and to all the major Asian countries like China, India, Indonesia, Malaysia, Pakistan and Thailand. One would also expect many African countries to gain. The food trade balance, which has sharply turned against developing countries in recent years, would become more favorable to them. At the same time, the industrial countries will avoid the large real income losses they currently incur by supporting their farmers.

Were we in the 1930s, this kind of reasoning would have been more than enough to bring forth strident pleas for free trade from Maynard Keynes and others. These days, however, it is more fashionable among economists to settle for moderation and partial reforms. Nonetheless, it is useful to construct free trade scenarios as bench marks for assessing other international policy initiatives. Tyers and Anderson in Australia, and IIASA in Europe, have made such attempts; the former also produced a special exercise to help us write the World Development Report 1/. In addition, there have been a series of less ambitious studies by many others, most notably by Valdés and Zietz 2/.

Quantitative free trade scenarios are subject to a great many limitations, as duly and extensively noted in the World Development Report. They are illustrative of what might happen, rather than actual forecasts. Nonetheless, on the basis of temperate-zone products only, Tyers and Anderson estimated that if all countries liberalized their policies simultaneously, industrial market economics would gain about \$46 billion annually and developing countries about \$18 billion. The estimated gain to industrial market economics easily exceeds the total annual volume of official development assistance they provide. The gains would be much larger than this if trade restrictions on tropical-zone and processed agricultural commodities were also reduced or eliminated.

1/ Tyers and Anderson, 1986.

2/ See Valdés and Zietz, 1980.

Another interesting and beneficial effect would be on the variability of world prices of agricultural commodities. The variability that one observes in world markets is only partially due to climatic factors and the relatively lower supply and demand elasticities of agricultural products. The insular policies that both developed and developing countries follow, contribute substantially to the variability --each country tries to "pass on" price fluctuations to others. This is obviously the case of sugar --the most unstable commodity-- where the free market is in fact a residual market. Even in the case of wheat, studies indicate that the coefficient of variation might be halved with free trade. While price variability may still remain higher in agriculture than in manufactures, the difference will be greatly narrowed.

As the free-trade bench marks suggest, the farm policies in OECD countries have indeed distorted the pattern of world agriculture. In fact the current crisis in world agriculture has much to do with the increases in protectionism in some of the OECD countries during the last decade or so. It is easy to see that the extremely low level of commodity prices at this time is not simply a demand problem. The so-called "high" scenario in the 1986 "World Development Report" indicated GDP growth rates of 4.3 and 5.9 percents for the developed and the developing countries respectively during the decade of 1985-95. There is no presumption at this time that such growth rates will indeed be achieved; but even if they are, the demand growth would only be marginally less than it was during the 1965-73 period. And in that earlier period, protectionism in the OECD countries was much less and the technological revolution in agriculture could be ameliorated by a resumption of the type of growth rates seen in the 1960s, but it will not by any means disappear unless the incentive policies change, especially in Europe, Japan and the United States.

Lest it be thought otherwise, the OECD policies are not solely responsible for the problems in world agriculture. The policies in developing countries have much to do with them. One of the most interesting discoveries of the analysis by Tyers and Anderson is the extent to which insular policies in developing countries contribute to the instability in world commodity prices, even in the case of grains. While few developing countries can hope to affect the levels and variability of grain prices in the world, as a group they do so to a very significant extent. And as was also brought out in the World Development Report, the developing countries as a group will benefit significantly from free trade if, and only if, they reform their domestic agricultural policies in the directions outlined in the previous sections.

What strategies should developing countries adopt in "bargaining" on policy reforms? Should each developing country adopt "anti-dumping" tariffs to offset the subsidies on exports from OECD countries? Should developing countries resume their efforts to improve policies on international commodity agreements, food aid and special trade preferences?

Given their efforts to improve their own policies, the developing countries as a group would clearly gain most from a free trade regime in world agriculture. Of course, not all developing countries would gain equally, and some might even lose from a significant move towards free trade. But our analysis showed that when losses occur, they are very small and of no significance compared to the distributional effects of the various types of "external shocks", such as the changes in the price of oil, that have occurred in the past. To ensure that no one loses, all that is required is marginal adjustments to the allocation of aid and capital flows to developing countries. Free trade in agriculture would be as close to being a Pareto improvement as any other policy change one can think of. Initiatives, such as changes in commodity agreements, trade preferences and food aid policies, pale into insignificance in comparison to the free trade alternative.

It is not in the interest of any developing country, considered individually, to impose tariffs and export subsidies solely as anti-dumping measures. The border prices they face define their best opportunities. However, agricultural support policies in all developing countries would benefit the world as a whole by shifting production away from the OECD countries. One caveat to this --and possibly an important one-- is the prevalence in Europe, and to a lesser extent in Japan, of variable levy schemes which completely insulate domestic prices from world price changes. If that insulation is maintained then surpluses will continue to occur regardless of the policies in developing countries.

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The Adjustment Process in America Latina 1/

1. The adjustment process

a. The origins of the crisis and the need for adjustment

Latin America's debt crisis exploded in August 1982 when, as a result of Mexico's debt moratorium, banks cutback lending abruptly, thus forcing the region virtually to close an ongoing current account deficit of \$40 billion (equivalent to about 35% of its exports of goods and services and some 6% of GDP) in but two years.

Nevertheless, at least in the oil-importing countries of the region the need to adjust had an earlier origin. It was set off by the oil price hike of 1979 and the subsequent reaction this elicited in the OECD. The simultaneous pursuit of anti-inflationary policies in the industrial countries, coupled with the decision to target money growth and not interest rates in most economies of the OECD, induced a prolonged recession in the North, together with unusually high real interest rates.

Oil importing LDCs were thus faced with huge and simultaneous increases in both their oil import bills and interest payments, at the very same time that the contraction in international trade lowered the prices and the demand for their primary commodity exports. Considering the crisis to be cyclical, and therefore a passing phenomena, nearly all of them borrowed heavily to finance their rising current account deficits, most, largely to maintain consumption. Only a few, in particular Brazil, invested to increase its export capacity and more especially to substitute energy imports. Others, especially in the Southern Cone, also borrowed to use imports to help lower inflation, thus leading to ever more overvalued exchange rates.

For their part, oil exporters, buttressed by forecasts of independent analysts of ever growing energy prices, also borrowed heavily, both to expand energy production as well as to raise public and private consumption more in line with what they regarded as their new and much higher expected permanent income.

1/ The original document was written in English by Economists Andres Bianchi, Robert Devlin and Joseph Ramos. Its does not necessarily reflect the opinions or official policies of the institutions for which they work, neither those of the World Bank or the Interamerican Institute for Cooperation on Agriculture.

Since banks were once again awash in liquidity, they attempted to recycle petrodollars nearly as quickly and easily as they had done after 1973. In merely two years, 1980 and 1981, the region's external debt rose some \$100 billion to nearly \$290 billion, financed mostly by commercial banks. Banks increased lending sharply, apparently unconcerned with the fact that by 1979 debt/export ratios were much higher than in 1973 (2.1 vs 1.4). Even more, banks overlent at one and the same time to borrowers with conflicting interpretations as to the nature of the shocks (losers considering it transitory; gainers, permanent) and hence with different and mutually incompatible rationales for borrowing. Thus the debt crisis was the outgrowth of imprudent lending as well as spending.

To be sure, it was difficult in 1979 to foresee the magnitude and duration of the OECD's recession, the exceptional rise in international interest rates, or the length and depth of the depression in the prices of basic commodities (except oil); and certainly it would have been even more difficult to predict the coincidence of these three events. Indeed, had real interest rates remained at, or soon returned to, their historic levels (2%), and had the unit prices of the region's basic commodity exports (exclusive of oil) maintained their long term values (1950-70) in real terms, the external crisis would have been relatively mild, and the region would have been in current account surplus (i.e., able in theory to reduce debt) from 1983 onwards (see Table 1). Unfortunately the crisis proved to be so severe because its protracted nature rendered permanent the damage of even presumably cyclical factors.

This heady but unstable state of affairs came to a close in 1982 with the prolongation of the recession in the OECD and the Mexican debt moratorium, as banks grew fearful of their exposures in Latin America and sharply reduced lending. Because of this abrupt fall in net capital inflow, Latin America could no longer finance current account deficits of the colossal magnitude it had run in 1981-82, or even the more modest deficits recorded in 1977-79. Adjustment hence became mandatory in nearly all countries.

b. The phases of the adjustment process

From the beginning the adjustment process had to be carried out under very unfavorable external conditions. International interest rates reached an alltime maximum in 1981 and in real terms remained at the highest level in half a century until 1985. The prolonged and deep recession in the OECD countries contributed to the slowdown of international trade and to the sharp and generalized decline in the prices of primary products, setting off a continuous and marked deterioration in Latin America's terms of trade.

Moreover, since the second half of 1982, voluntary lending by the international commercial banks disappeared altogether, thus abruptly reversing its steep and sustained upward trend between 1970 and 1981. Because of this shift, and in spite of the IMF-led efforts to organize rescue packages to help the most heavily indebted countries meet their external commitments, net capital

inflow to Latin America plunged from an all-time high of \$37.5 billion in 1981 to a mere \$3.2 billion in 1983 and fluctuated around \$6.5 billion in the three following years.

Such a radical drop in external financing would have been difficult to handle under any circumstances. In this instance, however, its negative effects were compounded by the simultaneous and also sizeable increase in factor payments and, in some countries, by large capital flight. In fact, after rising by 40% to a record level of nearly \$39 billion in 1982, net payments of interests and profits hovered around \$35 billion thereafter, thus doubling their average level in the four years preceding the crisis.

The increase in factor payments and the near collapse of net capital inflow led, in turn, to a sudden and dramatic reversal in the external transfer of resources. In effect, after receiving net resources from abroad amounting to an annual average of \$13 billion in 1978-81, Latin America was forced to transfer to the rest of the world more than \$26 billions per year during 1982-86. Hence, whereas in 1978-81 capital flows not only covered amortization and all interest payments but also added to the region's import capacity the equivalent of 18% of the value of exports, in 1982-86 the net transfer of resources was strongly negative and subtracted from the import capacity an amount equivalent to approximately 25% of the region's total exports. This shift was therefore equivalent to the effect of a 36% fall in the terms of trade and hence doubled the deterioration in fact suffered by the latter. Thus, since 1982, rather than serving as a means of coping with external disequilibrium, the pro-cyclical character of private capital flows aggravated the crisis and constituted an additional factor to which the region had to adjust.

Phase I: Recessionary Adjustment (1982-83)

Because of this unfavorable external environment, the Latin American countries were forced to effect the adjustment process with astonishing speed. Hence, notwithstanding the higher level of interest payments, the region's current account deficit was cut from over \$40 billions in 1981-82 to less than \$0.2 billions in 1984. This virtual elimination of the current account disequilibrium was brought about by an impressive turnaround in the trade balance, which, after recording a deficit of nearly \$2 billion in 1981, marked up a surplus of over \$39 billion in 1984 (see table 2).

Nevertheless, because of the way in which it was achieved, the closing of the current account deficit entailed large costs in terms of output, investment, employment and living standards. Due to Latin America's still very heavy dependence on primary products for its export earnings and the drastic fall in the international prices of most commodities, the value of the region's merchandise exports, after declining in 1982 and 1983, barely recovered in 1984 the level obtained before the crisis, in spite of a 20% expansion of their

volume between 1981 and 1984. Hence, the entire burden of correcting the huge initial external imbalance had to be shouldered by imports, which plunged from US\$98 billion in 1981 to \$56 billion in 1983 and stabilized at less than \$60 billion in 1984-86.

Of course, this drastic cutback in the value of imports reflected in part the excessive level that these had reached in 1981, at the height of the period of easy and overabundant external financing. Nevertheless, the contraction in the volume of imports was so enormous (35% in 1982) that it went well beyond the "fat" existing in the pre-crisis import bills (luxury consumer goods, military hardware and less urgent capital goods), so requiring sharp cutbacks in the imports of indispensable inputs, as well.

Consequently, and in spite of the rapid pace of import substitution --which manifested itself partly in the plummeting of the import coefficient to its lowest level in 40 years--, the reduction in the availability of imports had strong recessionary effects. In 1982 and again in 1983, the region's GDP fell for the first time in the whole post-war period while fixed investment contracted by 30%, failing to meet even replacement needs in several countries. By 1983, output per capita was fully 10% lower than in 1980 and had fallen back to the level already reached in 1976. Moreover, because of the deterioration in the terms of trade and the increase in factor payments, the reduction in national income per head --by far a better indicator of economic well-being than GDP per capita-- was even larger (-14%).

Phase II: Adjustment with partial recovery
(1984-85)

However the recessionary nature of the adjustment process seemed to change in 1984 as the downward trend of economic activity was interrupted. In effect, favored by the acceleration of world trade and in particular by the huge increase in US imports, and stimulated by higher real effective exchange rates, exports rose almost 12%. This and a partial recovery of net capital inflows made it possible for imports to increase moderately, thus facilitating the first rise in GDP per capita since 1980. At the same time, the region's current account deficit virtually disappeared, primarily as a result of the amazing improvements in the external accounts of Brazil (which completely eliminated the huge current account deficit of \$16 billion it had recorded in 1982), Mexico (where a current account surplus of over \$4 billion replaced the \$14 billion deficit registered in 1981) and Venezuela (which, after incurring a \$4.2 billion deficit in 1982, ran a \$5.4 billion surplus in 1984), and the sharp reductions of external imbalance in Argentina, Chile, Ecuador, Peru, and Uruguay, all of which had by 1984 cut their 1981-82 current account deficits by at least 50%.

The fact that in 1984 Mexico and Brazil --by far the two most indebted countries in the region-- as well as Venezuela --the fourth largest debtor-- covered all their interest payments with their respective trade surpluses and that Argentina, Ecuador and Peru generated trade surpluses that financed nearly 60% of interest payments, together with improvements in the debt

renegotiation mechanisms, prompted optimistic assessments in some circles about the prospects of the adjustment process. In this view, the fact that the huge external imbalance had been completely closed in the surprisingly brief span of two years, seemed to open the way in several countries for the resumption of growth with external equilibrium and, in some cases, renewed access to voluntary lending by the banks.

Phase III: Frustration of Expansive Adjustment
(1986-19?)

These expectations were, however, to be short lived. By mid-1985, Mexico --the "model adjuster"-- was facing severe balance of payments difficulties primarily because of having let its currency again become dangerously overvalued, with the consequent need to strongly devalue. At the same time, Latin America's terms of trade fell once more, thus continuing the downward trend, which had been only briefly interrupted in 1984. Moreover, in December oil prices began their precipitous dive.

Because of this massive external shock, and in spite of the relief brought about by the decline in international interest rates, the balance of payments situation of the oil-exporters deteriorated markedly. By the end of 1986 their combined current account surplus of \$8.6 billion in 1984 had been replaced by a deficit of about \$7.5 billion, and their trade surpluses financed only one-fourth of their interest payments instead of all of them as in 1983-85 (see table 3).

The trend toward a sounder external position was also reversed in 1986 in Argentina --both because of a sharp fall in the terms of trade and a large increase in imports-- and, surprisingly, in Brazil. In this latter country --which in the two previous years had succeeded in combining rapid economic growth with almost total equilibrium in its current account, thanks to the vigorous growth and diversification of exports and the impressive substitution of imports-- the trade surplus virtually vanished in the last quarter of 1986 as a result of the extraordinary expansion of domestic demand unleashed by the Plan Cruzado. Hence, in spite of being favored by significant positive external shocks in the form of lower oil prices and lower interest rates, both the current account and the overall balance of payments closed with deficits in 1986.

Thus, among the highly indebted countries of the region, only Chile --because of the fast expansion of non-copper exports and considerable import substitution in agriculture and manufacturing--, Uruguay --thanks to the strong recovery of exports, which benefitted greatly from the huge increase of Brazilian imports--, and Colombia --whose exports rose spectacularly as a result of an unusual combination of high coffee prices, the rapid growth of exports of coal and petroleum (made possible by the coming on stream of big investments undertaken in previous years) and significant expansion of manufactured exports (under the stimulus of a high real effective exchange rate)-- were able in 1986 to record advances along the path of adjustment with growth that seemed to be open in 1984.

Nevertheless, because of the worsened external situation, in 1986 debt indicators in most countries markedly deteriorated. Debt to export ratios shot up 17%, rising, on the average, even in oil-importing countries, so that they reached a new historic maximum of 4 to 1 for the region as a whole. Hence, after five years of adjustment, debt to export ratios were 60% higher than in 1981 --when they had already surpassed critical thresholds-- and interest payments to export ratios were 20% higher, notwithstanding the fact that LIBOR fell by well over 50% between these years.

c. The domestic policy response

Adjustment requires expenditure reduction, expenditure switching and structural transformation policies. No longer having financing available to support transformation, adjustment necessarily fell on the former, normally under the aegis of IMF agreements. Generally speaking, demand was restrained via the reduction of both fiscal expenditures and real wages; interest rates were increased to promote exports and discourage imports; while commercial policy (tariffs and export incentives) tended to be modified in this same direction. Thus the adjustment process was impressive in terms of the variety of instruments used and the extent to which these were modified.

As can be seen in figure 1, real effective exchange rates have been raised sharply almost throughout the region --such increases reaching over 50% with respect to the trough of the crisis in Argentina, Chile, Colombia, Ecuador, Mexico, and Uruguay, though these higher rates were not maintained consistently (as is especially true in the case of Mexico). Indeed so severe was the crisis, that it often gave rise to multiple exchange rates --one for traditional exports and preferential imports, another (sometimes free) for other trade flows, and yet a third for debt service payments, in addition to a free market or parallel rate. Such a phenomenon occurred even in countries characterized in the past by single, often times fixed, rates (e.g., Ecuador, Mexico and Venezuela) and, indeed, for a time also affected countries with a neo-conservative bend (e.g., Argentina and Chile in 1981 and 1982, respectively).

Commercial policy was widely used as well to discourage imports and encourage exports, especially in the period 1982-84. Tariffs and import surcharges were raised significantly and foreign exchange for travel reduced in Brazil, Costa Rica and Peru, among others, while tighter quotas (or bans) were placed on imports at least for a time in most countries of the region. Even in Chile, tariffs were raised from 10% to 35% before they were finally left at 20%; in addition, surcharges were imposed on some manufactured import and large implicit tariffs were established on imports of wheat, sugar beet, and oil seeds through the policy of agricultural support prices. Nevertheless, to the extent that the exchange rate has been sharply raised, the pressure to increase tariffs has abated in most countries. Thus, since 1985 many of the restrictive measures placed on imports after 1982 have been relaxed.

Export incentives, especially for non-traditional products, be they in the form of tax rebates, tax credits, subsidized interest rates for export financing, or duty free zone arrangements have been implemented in Brazil, Colombia, Mexico, Chile, Peru and Uruguay, among others. Yet, except for Brazil, these have not been as important a factor in trade policy as increased import restrictions. In any event, contrary to the latter case, most export incentives established during the crisis still remain in place.

As for policies to restrain demand, fiscal expenditures tended to fall in real terms throughout the region, especially between 1982 and 1984. Real expenditures were cut 20% or more in Argentina (1982-1985), Ecuador (1982-83), Mexico (1983-84), Uruguay (1982-84) and Venezuela (1982-83); smaller but sizeable cuts were also registered in Brazil, Chile, and Peru. Only Colombia, which really did not face a debt crisis and had accumulated large international reserves during the coffee bonanza of the mid-70's, continued to increase real fiscal outlays until 1984.

As could be expected, the heaviest reductions were made in capital expenditures, closely followed by declines in public sector wages. Other current expenditures proved difficult to cut; indeed interest payments rose throughout the period. Though emphasis was placed on reducing investment in machinery (to save scarce foreign exchange) public investment in construction also fell sharply, thus negatively affecting domestic output (and in this case with a low, direct, import component). In fact, construction is the activity whose output has been most seriously affected (falling almost 20% between 1981 and 1984). Moreover, it is to be noted that in the three countries (Argentina, Uruguay, and Venezuela), where construction has been most depressed (operating in 1986 at some 50-60% of 1980 levels), total GDP in 1986 was still well below 1980 levels, whereas in the rest of the region it had surpassed that level by 1985-86.

Notwithstanding efforts to cut fiscal expenditures, these failed to be matched by like reductions in fiscal deficits. For fiscal revenues are highly sensitive to the economic cycle, and, as already noted, until 1983 adjustment tended to be recessive. For example, Peru's deficit rose from 4% to 5% of GDP between 1982 and 1984, despite a 9% cut in real expenditures, because revenues fell 14% as total output declined 7%. Much the same occurred in Argentina and Chile in 1982 and Uruguay 1984. In such circumstances, larger deficits were a sign not of increased excess demand as is normally presumed, but of a demand deficient recession.

Conversely, success in lowering fiscal deficits during the adjustment process was associated not only with cuts in expenditures but with the ability to maintain or even raise fiscal revenues. The most dramatic reductions in the weight of public deficits in GDP were achieved in Argentina (8 1/2 points in 1985), Bolivia (10 points in 1986), Ecuador (6 points in 1982-85), and Mexico (9 points in 1983), countries which in those periods succeeded in raising government revenues significantly. In particular, fiscal revenues rose sharply in countries with dramatically reduced inflation (Argentina and Bolivia) because as inflation declined, the loss in real revenues arising from the lag in

collecting taxes fell. Elsewhere revenues rose because efforts were made to increase general tax rates (e.g., Mexico raised the value added tax in 1983 from 10 to 15% for all but necessities), to reduce tax evasion, and to adjust public sector prices. In this latter regard, the rise of public utility rates and of the prices of goods produced by state enterprises in Mexico in 1983 and in Argentina just before the start of the Austral Plan made important contributions to the reduction of the government deficit. Even more noteworthy was the case of energy prices in Bolivia: as part of the 1985-86 stabilization program, special taxes were placed on these products, so that revenues arising from them came to constitute over 1/2 of total fiscal income and over 5% of GDP.

Wage policy too was an important component of expenditure reducing adjustment packages in most of the region. Thus, except for Argentina's short lived effort to raise real wages in 1983-84 --which finally gave way to runaway inflation in 1985; Brazil's policy of increasing real wages in 1985-1986, and Colombia --where wages went on increasing until 1984--, in the rest of the heavily indebted countries of the region real wages fell very sharply during the crisis (see table 4). Worse yet, in Ecuador, Mexico, Peru, and Uruguay through 1985, this decline far exceeded the fall both in per capita national income and output, thus suggesting that up to that year adjustment in these cases was unnecessarily regressive as well as costly.

Finally, credit has tended to be tightened and interest rates were sharply raised during the adjustment program. Thus whereas negative real interest rates characterized much of the region before the crisis, real interest rates now are positive, and often excessively so. For example, real rates of over 5% per month have been observed in Argentina, Bolivia, and Brazil, and for considerable periods of time.

The objective of all of these policies was to shift output to tradeables, and expenditures to non tradeables, as well as contain capital flight. While, as already noted, these policies succeeded in virtually eliminating the region's current account deficit by 1984, they did so, not so much because output shifted, but because expenditure fell, compressing imports and stunting growth.

It is not that switching policies failed to increase exports. In fact, export volumes increased 27% in the region since 1980 (and 34% for non oil exporters) despite the world recession and the difficulties of increasing exports for countries so heavily dependent on basic commodities. Yet the fall in the unit value of exports in that period (20% for non-oil exporters, 45% for oil exporters) wiped out in the case of the latter or virtually wiped out in the rest the effects of the increased volume of exports achieved in this period (see figure 2).

In this same vein, it is worth noting that the speed with which switching policies in fact succeed in reallocating resources to tradeables depends not only on correct price signals but on the volume of investment. Thus while the proportion of investment allocated to tradeables probably rose, the amount of investment in tradeables may not have in fact grown much, for overall

investment fell by almost one-third in 1983-85 as compared to 1980. It is to be noted that this sharp decline in investment took place despite the fact that domestic savings help up, and indeed rose, as a percentage of gross domestic income, a remarkable fact given the simultaneous and sharp fall in per capita income. Rather, higher savings failed to materialize in greater investment because of increased interest payments and the sharp reversal in the net transfer of resources. Thus, whereas the share of savings in gross domestic income rose from 22% in 1980 to 23% in 1985, the investment coefficient in the same period fell from 24% to 16% (see figure 3).

It is not surprising then that significant structural transformation of output was largely limited to two countries, Brazil and Colombia. The latter was able to maintain, indeed raise, the investment coefficient until 1983 and thus by 1985-86 was deriving important increases in foreign exchange from the coming on line of investments in oil, coal, and nickel. Brazil for its part invested heavily in the second half of the 70s, while financing was available, in petroleum, energy substitution (cane alcohol), chemicals, heavy metals and fertilizers, which allowed it to substitute energy imports and increase exports sharply after 1981. Thus structural transformation in its case began to take place with the investment program designed after the oil crisis of 1973.

However, it is understandable that, once outside financing dried up and interest payments rose, investment would naturally be called on to bear the brunt of adjustment in most countries, thus slowing structural transformation. Nevertheless, it is noteworthy that countries did not shirk from checking consumption in order to try to raise savings. In fact, consumption per capita in the region fell almost 10% on the average during the crisis, often times cutting into critical expenditures such as health, education and nutrition.

In short, despite the efforts to increase exports (not simply compress imports), to check consumption and raise savings (not simply cut investment), and to reduce expenditures (but not output), adjustment was largely achieved at the expense of growth. This outcome was due not to the absence of switching policies, but to the fact that, given the magnitude of the needed turnaround in the trade balance, the brief time span available to effect it, and the unfavorable evolution of the world economy, the income effects of switching policies (contractive) swamped the substitution effect (expansive), thus accentuating rather than mitigating the recessive impact of expenditure reducing policies.

Consequently, adjustment --which necessarily entails lowering the level or the rate of growth of domestic absorption-- unnecessarily cut economic growth as well, with per capita output in 1986 for the region as a whole still being 8% below 1980 levels, thus making this decade a lost one for most of the countries. What is worse, given the deterioration in the region's external situation in 1986 and its heavy debt burden, the adjustment process has proven to be not only costly and inefficient, but indeed far from complete and its final outcome is uncertain.

2. Why has adjustment been so costly and protracted?

In general, the costs of adjustment depend on the structure of the economy and its capacity to respond, on the effectiveness of policy and on the international context in which it is effected. All three of these factors, together with the exceptional size of the initial external imbalance, contributed to the severity and duration of the adjustment process.

a. Weak initial position

Four features characterized the bulk of the region's economies at the onset of the crisis, which both magnified the nature of the shock, and limited the speed and capacity of the response (see table 5).

The first was a high level of debt. In fact, the debt-led growth strategy pursued in the region between 1970 and 1981 raised the debt/export ratio from 1.4 in 1973 to 2.5 in 1981 (as opposed to 1.0 in South Korea); moreover interest payments that year amounted to 28% of exports (tripling their percentage of 1973). Hence, in 1981 the region was far more vulnerable to interest rate hikes than were other countries or than it itself was at the beginning of the 1970s. Moreover, precisely because indebtedness was reaching precarious limits, countries would be unable to long draw on capital inflows to compensate deteriorations in trade flows, as they did after the 1973 oil crisis.

The second was the high proportion of debt at floating interest rates. In the period 1970-81, commercial banks lent heavily to Latin America, so that by 1981 not only was the region's level of debt dangerously high, but some 2/3 of it was at floating interest rates. This again in contrast both to Asia in general (12%) and South Korea in particular (33%) as well as to the region itself in 1970 (less than 25%).

A third feature in most countries was the low levels of export relative to GDP. Despite a fairly strong export push in the 70s, when the value of exports grew 20% per year and the quantum of manufactures grew 15% per year, exports averaged 13% of GDP in 1979, and in few countries did they exceed 20% (as opposed to South Korea's 38% or Taiwan's 52%). To be sure, this was a reflection not of a God given fact, but of the policy option to pursue a largely inward oriented, import substituting development strategy in most of the post-World War II period. For this reason too, exports made up such a relatively low proportion of tradeables in Latin America, accounting for just 1/4 of total tradeables. So, at the beginning of the 80's the region in fact possessed a very low export (and import) base from which to adjust trade flows (either by further import substitution or by export expansion) to external shocks.

Finally, a fourth crucial characteristic was the very high dependence on the export of primary commodities. Over 75% of Latin America's exports was made up of a relatively few, natural-resource-intensive commodities. On the one hand, this led to sharp fluctuations in the terms of trade; on the other, because such goods are relatively inelastic both in supply and demand, it

provided a very restricted margin for adjustment via export expansion. This in contrast to South Korea and Taiwan, where 80-90% of their exports was represented by far more price and income elastic manufactures.

The first three problems were largely policy determined whereas the latter also reflected Latin America's rich natural endowment of resources. Yet, whatever the cause, these four factors heavily conditioned the region's adjustment process. Thus, unlike what happened after the 1973 crisis, when the region was able to compensate its equally rigid and limited export structure by drawing heavily on capital inflows until the OECD's recession was over and the quantum and value of its exports picked up, at the beginning of the 80's this latter route would be severely limited because of the region's already heavy debt and exposure in the banking system. Indeed since real interest rates shot up and bank lending eventually collapsed, capital inflows soon ceased to be a variable which could ease trade adjustment, but rather became a variable to which the region had to further adjust.

Nor was the region able to pursue an expansive adjustment on the basis of its export base as did South Korea. For since export expansion need come largely from manufactured exports, and since these accounted for but one-fourth of total exports and less than 5% of GDP (as opposed to 85% of exports and 45% of GDP in both South Korea and Taiwan), no reasonable short run growth of non-traditional exports could correct the external imbalance which the region was forced to eliminate. Thus, in the brief time frame available, adjustment could hardly be expansive, but had to be based largely on recession-inducing import compression.

b. Policy shortcomings

However limited the degrees of freedom of policy response, once the crisis set in, there was nevertheless still some room for maneuver. Obviously, then, some of the variations in the costs of the crisis can be attributed to the differing policy responses provided. While in general, domestic policies moved in the right direction, in many instances response has been sluggish, shortsighted, incoherent or lacking in continuity.

The single most serious error in policy in most oil importing countries of the region (with the important exception of Brazil) was the decision to use the strong capital inflows of 1979-81 to postpone rather than to facilitate adjustment. Thus rather than augmenting investment, the bulk of such inflows went to maintain, or even raise, consumption, and in some countries, facilitate capital flight; and unfortunately much of the investment made was, in fact, poorly allocated, at least in part because relative prices were distorted due to exchange rate policies aimed at combatting inflation rather than maintaining external equilibrium.

In the same vein, Chile's persistence in maintaining its fixed exchange rate well into 1982, in the hopes of achieving a real devaluation via a reduction in absolute prices and wages is a prime example of policy sluggishness or obstinacy in the face of facts. This policy, which was followed closely by Uruguay, no doubt helps explain the severity of the ensuing recession in both these countries in 1982 (-13% and -10% respectively). So too, if to a lesser extent, was the failure of most oil exporters to set domestic energy prices at international levels. Venezuela was by far the most laggard in this regard, gasoline retailing for less than 5 cents a liter as late as 1985 when the international price was five times that. Not only did such a policy foment excessive domestic consumption, but it reduced fiscal income.

Policy instability has also been a serious problem which has tended to prolong, if not accentuate, the crisis. National currencies have been devalued to raise real effective exchange rates throughout most of the region. Yet movements have often been extremely erratic, with cycles of overshooting and undershooting, making it very difficult for would-be exporters to determine whether, in fact, there be any but a momentary advantage in exporting, and so effectively discouraging them from incurring the costs of penetrating and developing markets. Mexico's exchange policy is probably the most notable example of such policy discontinuity: the real effective exchange rate doubled between the end of 1981 and the end of 1982; then it was allowed to fall steadily through mid 1985, almost reaching its 1981 trough once again, before it was pushed up 30%. Such a roller coaster exchange policy could hardly serve as a useful signal to exporters. While Venezuela's exchange rate has fluctuated in less extreme fashion, it has unfortunately allowed the real effective exchange rate to continue to fall in the face of the collapse in energy prices in 1986 (see figure 4).

Another variant of policy instability is given by the frequency of changes in exchange rate regimes in Chile in 1982. The year began with a fixed exchange rate; adjustment was to take place via price declines. However, in mid year, this policy was reversed: the exchange rate was raised 18% and a further monthly devaluation of 0.8% was pre-announced. Two months later, a third regime was enacted --a free float (to save reserves). Within a month, this became a dirty float (scarce reserves again being used to control the exchange rate), while a preferential rate was set for service of the foreign debt. One month later, a formally controlled, crawling peg was reestablished (after a further devaluation). Thus five exchange regimes were experimented within less than six months time.

Wages and interest rates have been subject to fluctuations of almost equal severity. For example, real wages fell 20% in Argentina between 1980 and 1982, grew 59% in the next two years, and then fell again 15% in 1985. Given such behavior, employers are simply apt to hire in accordance with expected labor costs, rendering employment inelastic to any but the sharpest variations in ongoing wages. These thus cease to serve their allocative role in the economy, which simply confirms the acute zero-sum conflict mentality prevailing in many countries, and renders efficiency considerations marginal in

the face of distributive concerns. As for interest rates, whereas negative real rates tend to misallocate investment, unduly high rates (which as in Argentina and Bolivia have reached 5% real per month) simply choke it off.

Adjustment policy has not only been sluggish, shortsighted and unstable; at times it has been inconsistent. An example of this was Brazil's policy during 1986. Though the Plan Cruzado was well designed conceptually --in its insistence in the feasibility of ridding the economy of the inertial component of inflation without recession-- it was mistaken in two issues: 1) as a matter of empirical fact, the operational deficit was not zero (as the Plan's authors apparently thought to be the case); hence there was a disequilibrium component of inflation to be attacked along with the inertial one; and 2) in its assessment that to avoid the risk of recession, an 8% real wage increase should also be decreed at the onset of the Plan. The result is well known: an extraordinary boom, which led to scarcities and repressed inflation on the domestic front, at the expense of external disequilibria and the resurgence of inflation at the end of the year. In fact, the trade surplus fell from \$1 billion per month in the first nine months of 1986 --sufficient to fully cover interest payments-- to about \$180 million per month in the last quarter, while consumer prices rose over 7% in December and were expected to increase at an even faster pace in January and February. Thus Brazil will need to adjust and fight accelerating inflation in 1987 as well as seek out new money from the banks.

Important components of adjustment policy have at times been in error as well. In Mexico, the growth in nominal wages was sharply curtailed between 1982 and 1985 in an attempt to bring down inflation, and yet to little avail. Inflation rebounded to 100% in 1986 (never having gone below 60%), whereas real wages have, in fact, been cut 26%. Since this is double the fall in per capita national income, this implies that the failed attempt to lower inflation led to an unnecessary, not to mention regressive, sacrifice of wages which was only partially offset by the apparent rise in modern sector employment.

Finally, one cannot fail to mention the inflationary escalation which occurred with the crisis. To be sure, the region has long been characterized by high inflation. Yet with the crisis, average inflation quintupled from 55% per year in 1979-81 to 275% in 1985 (before stabilization programs again lowered it to 70% in 1986). Indeed, in the course of the crisis 7 countries experienced triple digit inflation (and Bolivia over 23,000% per year in August 1985). Moreover, this strong inflationary escalation beset several countries heretofore characterized by relatively low inflation (e.g., Costa Rica in which it exceeded 100% in mid-1983; Ecuador, in which it exceeded 50% in 1983; Mexico in which it reached 100% in 1982 and again in 1986; Nicaragua in which it exceeded 750% in 1986; and Peru in which it exceeded 150% in 1985). To be sure, it is not easy to control domestic inflation in the face of a sharp hike in oil prices; and certainly the extraordinary magnitude of the adjustment required placed a demand on fiscal resources well beyond its proven capacity to satisfy in the short run (since fiscal deficits were already of the same order of magnitude) all especially when adjustment had to be effected in

the face of already high and persistent inflation, in economies characterized by widespread indexing. Hence, it is understandable that inflation has accelerated. Yet the fact that the magnitude of that acceleration often bore little relation to the size of the external (and fiscal) shock, denotes serious failings in policy design and implementation.

c. Unfavorable external environment

Nevertheless, the high costs of adjustment have been not so much the consequence of ill-designed or badly applied domestic economic policies, but, in most cases reflect the exceptionally adverse external environment under which the adjustment process had to be carried out. In fact, during the 80s the region has faced a uniquely grave external crisis in both trade and external finance, involving not only cyclical but also structural elements. Moreover, the negative consequences of the crisis have been compounded by the acute instability and unpredictability of world economic trends.

Managing adjustment has undoubtedly been rendered more difficult because of these erratic features in the world economy. Thus, the first rise in OPEC prices was generally viewed as temporary and it proved to be more permanent than originally thought, while the second price hike, which was generally viewed as permanent, turned out to be a temporary change. Similarly, over the last six years the dollar has soared and tumbled. So too, nominal international interest rates, after skyrocketing at the turn of the decade, began their downward course in 1982, but not before an unexpected and worrisome rise in 1984. In addition, they remained persistently high in real terms even after an extended period of world price stability. Meanwhile, recovery from the world recession in 1981-1982 has been slow and uncertain. The forecasts announcing the beginning of a strong recovery in the OECD in 1983-1984 did not materialize. Moreover, in subsequent years industrialized countries' annual performance has disappointed and frequently required downward revisions of world growth projections. And, of course, still looming large is the question how quickly the U.S., Germany and Japan will adjust to their respective trade deficits and surpluses.

In any event, the effects of adjustment policies have been limited and their costs have been increased by the insufficiency and burdensome terms of external finance as well as by the adverse trading conditions that most Latin American countries had to face since 1981.

The pro-cyclical retreat of creditors

As already noted, since mid-1982 net capital inflow to Latin America declined markedly, largely as a result of the withdrawal of the private banks, the region's principal creditors. Because of its size and suddenness, this pro-cyclical retreat of the banks was only very partially offset by the rise of net loans extended by the international and national public financial agencies. In fact, during 1982-85 total external finance fell far short of even the transitory components of the current account deficits. Thus, far from acting as a countercyclical force facilitating a gradual and efficient correction of external imbalances, external financing (or rather underfinancing)

forced Latin America to "overadjust". Moreover, in some countries --and especially in Argentina, Mexico and Venezuela-- what financing became available was sometimes eroded in its effect by the flight of private domestic capital to northern financial centers.

The adjustment process was not only handicapped by the scarcity of external financing but also by its high costs. When Latin America began to adjust, international interest rates were at record levels and acted simultaneously as a factor in the need to adjust, as well as in the costliness of the process. The LIBOR peaked at 16.5% in 1981, averaged 10.7% in 1982-85 and declined to an average of 6.7% in 1986, hovering around 6% by end year --its lowest level since 1977.

In spite of downward trend in nominal rates, real rates remained persistently high. The real LIBOR measured by the industrialized countries' rate of inflation averaged 5% in 1982-1986, which compares unfavorably with a real rate of zero in the 70s and a long term historical rate of around 2%. With nominal international interest rates falling much more slowly than the rate of inflation in the industrialized countries, there was in fact a "hidden" amortization of debt at increased real values. This in turn offset part of the relief provided by the creditors when they rescheduled "visible" amortization payments. But this tells only part of the story. The burden of interest payments depends too on the dollar value of the debtors' exports. Since Latin America's exports suffered generally declining prices during the adjustment period, the annual average real interest rate from their perspective was an extraordinary high 17% for the period 1982-1986. This compares with an average of -4% during the period 1971-1980, when most of the region's foreign debt was contracted (see table 6).

The fact that the real weight of interest payments remained burdensome throughout the adjustment process is seen in table 7. Notwithstanding lower nominal interest rates, since 1983 there has not been much change in the coefficient of interest payments to exports in the region, which has been stuck at around 35% and is, of course, higher in the most heavily indebted countries.

Private banks aggravated the problem of the cost of credit by jacking up their spreads and commissions, and shortening amortization periods, on rescheduled debt and fresh credit during the first round of the rescheduling exercises. It has been estimated that the negotiated cost of credit (based on spreads, amortization period and commissions) rose in most debtor countries by between 100 and 250% 1/.

1/ See ECLAC, External Debt in Latin America, Boulder Colorado, Lynne Rienner Publishers, 1985, table 15.

It is true that in subsequent rounds of rescheduling the private creditors have reduced the negotiated cost of credit in response to the stiffer bargaining positions of the debtors and criticism at home. Concessions have included multi-year reschedulings, lower spreads, longer amortization periods and the foregoing of commissions. By the third round in 1984/85, the negotiated terms were only slightly above, or below, those that countries were contracting before the crisis. Nevertheless, while the concessions have been welcome and helpful, they arrived late in the adjustment process and in general still lagged behind the reality of the situation of many borrowers. That is, while the banks made important concessions, they kept the negotiated terms at commercial levels, even though a number of problem borrowers were in need of non-commercial repayment terms.

Because of the abrupt fall in net capital inflow and the simultaneous rise in interest payments, Latin America has been experiencing since 1982 a protracted transfer of resources to its creditors that is non-voluntary, premature with respect to its stage of development, and large by any measure. In fact, in the last five years this transfer is estimated to be equivalent on average to roughly 4% of the region's gross domestic product and 25% of its export earnings. Moreover, the cumulative outward transfer in this period (\$132 billion) nearly doubled the cumulative inward transfer during the previous six years (see table 8).

Latin America's outward transfer also compares unfavorably with historically famous transfer cases, such as the war reparations effected by France in the 1870s after the Franco-Prussian War and Germany's payments to victorious nations after World War I. In fact, the weight of Latin America's financial transfers to its creditors in terms of the debtor nations' income and exports is almost twice that of Germany's and is roughly comparable to that of France (see table 9). More pertinent are the still more adverse results which emerge from comparing the real effective burden represented by the transfer of resources currently being effected by Latin America and those cancelled out by Germany and France in the past. To gain an idea of this burden, it is necessary to consider to what extent a transfer is facilitated by financial resources coming from other sources. For instance, Germany received loans and other foreign capital in excess of its war reparations through most of 1925-1928; hence, its reparations exceeded those capital flows only during the period 1929-1932. Consequently, in order to facilitate the transfer, Germany did not have to generate a trade surplus until 1929. France, on the other hand, ran a surplus throughout 1872-75, while Latin America has had a trade surplus since the outbreak of the crisis in 1982. However, the trade surplus in Latin America has been roughly double the magnitude of that registered in France and Germany, whether measured as a percentage of income or of exports (see table 10).

Because of both its size and protracted nature, the outward transfer of resources has severely limited the possibilities of successfully accomplishing a growth-oriented, structural adjustment process. In the first place, except in Colombia, Costa Rica and Peru, the transfer has siphoned off very large proportions of domestic saving, thus subtracting resources from the investment needed to stimulate the growth and transformation of the economy.

Indeed, as already mentioned, the reversal in the direction of the transfer of resources is the principal factor explaining the growing gap which has emerged in recent years in most countries of the region between a stable or rising domestic savings effort and a falling investment coefficient.

A second and no less important negative consequence of the outward transfer of resources has been the restriction it has imposed on the capacity to import, which fell abruptly in 1982 and has represented since then the most binding constraint on economic growth in virtually all Latin American countries.

Finally, in some countries, the transfer of resources has contributed to accelerate inflation. This is because most of the debt is by now guaranteed by the state, either because it was originally contracted by public agencies or because in the successive negotiation rounds the governments were heavily pressured by the banks to provide in one form or another "ex-post" guarantees to private sector debts that the banks had originally not requested and had charged appropriately higher premiums for. Thus, most of the transfer has had to come directly or indirectly out of government budgets. As Helmut Reisen has shown, this "budgetary phase" of the transfer process was generally not resolved during the 1982-1985 adjustment process. In this view, because of the huge budgetary burden involved, government found it "impossible" to enforce fully the required restrictive fiscal and credit policy 1/. Deficits resulting from the transfer burden and other factors as well had hence to be financed by borrowing from the domestic banking system with inflationary consequences.

Adverse trading conditions

The costs of adjustment have also been high because the process had to be carried out during a period of sluggish growth in the industrialized economies and in world trade. With the exception of 1984, economic growth in the industrialized countries during 1982-1986 was well below the average annual rate of 3.5% registered in 1968-1977. The same was true for the volume of world trade, whose growth was considerably below the 8% annual average mark registered over 1968-1977. Moreover, the strong growth of world trade volume (8.6%) recorded in 1984 was disproportionally reliant on the extremely robust expansion of the U.S. economy, which, after its 1982 slump, was the only major industrialized country to grow at a rate equal to, or greater than, its 1966-1978 average.

1/ Helmut Reisen, "The Latin American Transfer Problem in Historical Perspective", in OECD Development Centre, Latin America and the Caribbean and the OECD, Paris, 1986, pp. 151-152.

Under these circumstances, a significant part of the benefits that could be expected from the expansion of the volume of Latin America's exports were in fact offset by the fall in export prices. The figures in the first column of table 11 confirm that this happened to a considerable extent for nearly all the countries of the region, as the increase in the value of exports over 1982-1986 was but a small fraction of the rise in export volume. As might be expected, the most severe cases occurred among the oil-exporting countries, but non-oil exporters such as Argentina, Chile, and Uruguay also had a big part of their export effort frustrated by declining world prices for their goods. Brazil, which is much less dependent on exports of primary products, suffered somewhat less. Only Costa Rica and Colombia escaped running the treadmill of falling prices, mostly because of very high prices for coffee in 1986. It can also be noticed in the second column of table 11 that for the majority of non-oil exporting countries real devaluations during 1982-1986 were associated with a more than proportional movement in export volume. However, the corresponding relation for export value was positive only in the cases of Colombia and Costa Rica.

Another way of examining the adverse impact of trade conditions on adjustment efforts is to examine the region's terms of trade. Over the period 1982-1985 the loss of income due to the deterioration in the terms of trade was generally large. In fact, this loss was equivalent to nearly three-quarters of the region's total bill for net interest payments. Indeed for Costa Rica and Chile the loss of income stemming from the fall in the terms of trade was equal roughly to the value of net interest payments and for Uruguay it was substantially greater.

Finally, the negative effects of the evolution of world trade over this period can be seen by analyzing what would have happened if export prices had held their ground while the countries increased the volume of their exports in order to carry out an expansive adjustment. The figures in the last two columns of table 11 are suggestive. Valuing 1986 export with 1980 export prices provides for a sharp fall in the net interest payments/export coefficient in comparison with its actual 1986 level. Indeed, had export prices remained stable, the region's coefficient would be 24% instead of 35%. All countries except Colombia and Costa Rica show important declines in their respective coefficients. Moreover, some countries, such as Ecuador, Peru, and Uruguay would have recorded what might be termed acceptable coefficients and Venezuela's would have turned to be a remarkably low 9%.

3. Adjustment with growth: prospects and requirements

To be sure, while the region as a whole is in difficult straits, the situation differs significantly among countries. Colombia really no longer has a debt problem, if it ever had one; its ratio of debt to exports (2.0) and interest to GDP (3.0%) is below regional averages for 1980, before the crisis emerged, and its trade surplus allows it to meet almost 80% of its interest

payments (see table 12). And while Brazil's current account deficit increased markedly at the end of 1986, it did so because of excessively expansive domestic policies. Thus correction of this imbalance which "merely" requires redressing previous policy errors, needless to say, will be no easy task.

More complex, however, is the situation of Costa Rica, Chile, Uruguay, and Argentina, whose debt burden --as measured by interest payments to GDP--are among the highest in the region (9.1%, 8.4%, 6.5%, and 6.5%, respectively). Though the first three reduced their external disequilibrium markedly in 1986, their high level of debt nevertheless implies the need for long enduring, and except for Uruguay, even further adjustment. And while Peru's debt burden is lower than average for the region (its interest payments are just under 4% of GDP) its trade surplus disappeared in 1986 --in part because of a deterioration in the prices of its exports, in part because of its consumption-driven expansion. Finally, the major oil exporters (Mexico, Ecuador, and Venezuela), now face the stark prospects of adjustment on top of adjustment. Given their high debt burden, this process would seem to be manageable only if oil prices stabilize in the medium run at levels well above those prevailing in 1986.

Nevertheless, despite these differences, the basic problem is similar. Put in a nutshell, interest payments on debt amount to 5.3% of GDP, notwithstanding the fall in interest rates in 1986, whereas the trade surplus amounts to 2.3% of GDP despite the efforts of recent years. This implies that, were the terms of trade not to improve and were the region unable to attract fresh money, the meeting of interest payments would require an additional effort to improve the trade balance larger than that which has already taken place in the past five years in all countries except Brazil, Colombia, and Uruguay (see again table 12). Since this effort has driven per capita income well below 1980 levels in all but three countries (Brazil, Colombia, and Panama), small wonder that adjustment weariness has set in.

Recessionary adjustment is therefore no longer feasible, politically or socially. In fact, adjustment is acceptable only if it be subject to a minimum growth in output and consumption. This means that whereas under recessionary adjustment, debt service was the prime recipient of foreign exchange and growth a residual, in expansive adjustment, the first priority for scarce foreign exchange is to meet the import requirements for minimum acceptable growth, and debt service is the residual. In other words, whereas recessionary adjustment placed the onus of costs on debtors, expansive adjustment shifts part of the costs to creditors. Not only does expansive adjustment redress the heretofore exclusively one-sided nature of adjustment costs between creditors and debtors, but it also redresses the skewed absorption of these costs in creditor nations between its productive and financial sectors, that is to say, between OECD exporters and bankers for the reduced sales to the region by the former, largely account for the trade surpluses needed to meet interest payments to the latter.

At first sight, this reordering of priorities may not seem pleasing to banks or developed countries. Yet a moment's reflection should suffice to show that this more symmetrical approach is the only non-confrontational way to solve the debt crisis and to carry on the adjustment process.

For ultimately there are but two ways of servicing the debt of the LDCs: either via fewer OECD exports or via greater LDC exports. The first is the approach that has prevailed so far: only the banks will gain, while developed countries' growth and exports suffer, and LDC development is hamstrung. Moreover, the international financial system is jeopardized, the longer debtors are forced to stagnate, and consequently tempted to adopt unilateral solutions. Only with the second approach --growing out of the debt problem-- can all gain: a situation where banks are repaid from the growth of LDC exports and not from further import compression (at the expense of OECD exports).

This second approach requires the concurrence of the key participants --private banks, debtors, international financial institutions, and the governments of LDCs and of the OECD-- in recognition of the fact that the debt problem is a systemic one, and not merely one specific to, or brought on by, individual creditors or debtors. This is what the region means by a "political" solution to the debt problem.

To be sure, the strategy of growing out of the debt problem requires structural adjustment. Domestic policies need be pursued both to mobilize currently idle resources as well as to restructure production from non-tradeables to exports and imports substitutes. Yet expansive adjustment also requires adequate financing to provide the needed time for such transformation to fully take effect. Thus structural adjustment is the counterpart to adequate financing.

a. Domestic requirements

In the long run, to grow out of the debt problem requires a structural transformation of the economy in at least two senses: the growth strategy need be outward oriented and largely based on domestic efforts to raise savings and productivity. Hence foreign exchange, the savings/investment process and efficiency raising innovations will be the key bottlenecks to growth and the central focus of policy attention.

Outward oriented growth means that investment in the production of tradeables need increase markedly, both that which expands and diversifies exports as that which augments the region's capacity to efficiently substitute imports. This involves not only raising and maintaining the incentives for saving of generating additional foreign exchange (i.e., a high and stable real effective exchange rate), but of equalizing, on the margin and over time, the incentives or costs of saving additional foreign exchange via import substitution or generating it via export expansion. Given the strong bias of the past strategy of import substitution in favor of production for home

markets, presumably such an equalization of incentives will give rise to the expansion and diversification of exports far more than to further import substitution. Thus growth is likely to be not only outward oriented but also more export led and based especially on the expansion of manufactures and other non-traditional exports.

Given the debt burden and the likely insufficiency of voluntary capital inflows in the immediate future, this upsurge of investment in tradeables will have to be based largely, if not exclusively, on domestic savings. Still, given the pressing need to recover consumption levels, savings cannot be expected to do the job alone. Rather the productivity of investment and the overall efficiency of the economy will have to rise considerably. Fortunately, the disastrously high incremental capital output ratios of investments in the 70s suggests that there would be ample room for improvement in this regard.

In much the same vein, austerity implies not that distribution concerns be sacrificed, but that what efforts be made be focused on the especially needy lower 25% of the population. For not only are these groups living in abject poverty, but they receive but some 4% of GDP. Hence, even modest redistributive efforts (say 2% of GDP), which, spread over the bulk of the population (say the lower 80% which receive 50% of GDP), amount to very little, if focused on the lowest 25%, could eliminate extreme poverty, raising their income 50%.

Finally, the experience of the past 15 years suggests that it would be imprudent to organize economic structures in the expectation of a smooth and steady evolution of the international economy. Rather, strong fluctuations in the terms of trade, in real interest rates, in the value of the U.S. dollar and in the relative prices of basic commodities may be the rule rather than the exception. This not only heightens the importance to be attached to macroeconomic policy in establishing and maintaining basic internal, external and distributive equilibria, but it implies the further need to bias policy planning and economic structures in favor of flexibility.

It is likely that there will be much agreement among observers as to the importance of a less inward oriented, more export led growth, of greater domestic savings, of a more focused distributive effort, of far improved productivity and efficiency, and of the need for a firmer, more coherent and stable macroeconomic policy. Disagreements, however, are likely to emerge as to the means.

Thus, most will agree as to the critical importance of a high and stable real exchange rate in promoting exports and efficient import substitution. But commercial policy? To be sure, tariff "policy" in the region has been more the result of the principle "to each activity the protection it needs" --that is, protection at any social cost-- rather than the attempt to redress divergences between social and private costs associated with, say, infant industries, technological externalities, or labor market distortions. Yet more than their elimination, this implies that tariffs should be lowered to

levels proportionate to social (and not private) need; and where justified, they should be rationalized among sectors, so as to tend to equalize effective protection.

Moreover, to the extent that the arguments to protect a sector are socially valid, they justify equivalent incentives for production to all markets, external as well as domestic ones, --all the more so, if there are economies of scale. Put differently, unlike as was done in the past, when incentives were provided only for production for domestic markets (at the resulting expense of exports, especially non traditional ones), in the future these ought to be extended to production for international markets as well.

Nor does it suffice to do away with all tariffs and export incentives and replace these with a higher exchange rate. This would, in fact, be correct were all sectors to be deserving of equal amounts of protection and export incentives. Yet this would be an extreme case. More likely, important divergences between social and private benefits 1/ will occur in only some sectors, and are likely to vary in degree and over time. So that at one and the same time new activities may be receiving tariff protection; former import substituting activities that are coming of age will be increasingly receiving only export incentives; whereas fully mature activities would be receiving no special incentives at all.

A second critical bottleneck is the savings-investment process. Experience has clearly demonstrated the drawbacks of negative real interest rates, if not as to the amount of savings, certainly as regards the poor quality of investment: oversized plants, excessively capital-intensive technologies, investment determined by easy access to capital, rather than by rate of return, etc. Yet excessively high real interest rates have proven to be equally disastrous --leading more to the pursuit of ephemeral quasi rents (via financial speculation leading ultimately to a financial crash) rather than to investment in productive activities. The former are normally the result of long-term intervention in capital markets, the latter of financial market liberalization

1/ We say important divergences for it would be an administrative nightmare to try to compensate all theoretically conceivable divergences; much as it would be a gross oversimplification to disregard all such divergences, as do neo-conservative policy makers for the sake of administrative simplicity, and put policy on "automatic pilot", as if all such divergences were trivial or non-existent.

in the throes of disequilibrium, often arising out of adjustment or stabilization programs. Hence, a case can be made to move towards liberalization via transitorily controlled rates, keeping these positive, but not much above real international rates 1/.

In fact, liberalization would seem to be but one, and certainly not the most critical, aspect of improved capital markets. More important is the need to correct capital-market segmentation, both as between size of firms and types of credits. The fact that large firms enjoy easy access to capital, while small and medium sized firms have little or no such access, biases lending "backwards" to firms with guarantees rather than "forward" to firms with high prospective rates of return. And segmentation as between types of credit biases lending towards new equipment, which normally enjoys ample supplier credits at relatively low international interest rates, and away from used equipment and working capital, where financing, when available, is at high interest rates; and to compensate for the absence of critical sections of capital markets ---the most obvious being the virtual non existence of fluid, long term capital markets.

As for increased savings, these would seem to be more sensitive to appropriate fiscal policy than to higher (though certainly positive) real interest rates. Given the squeeze on consumption of the past five years, efforts should especially focus on channeling to savings far higher proportions of the new income generated in the recovery phase, be it that deriving from greater exports, improved terms of trade or lower international interest rates. This implies a "carrot and stick" policy: sharp increases in marginal tax rates, especially on increased consumption, and special incentives for savings.

Finally, the restoration and preservation of basic macroeconomic equilibria implies not only the reduction in the current account deficit (external equilibrium) but the reduction in the unemployment of labor and in the generally widespread levels of underutilized capacity (internal and distributive equilibria). Though the simultaneous achievement of the three is a difficult task, it is the only way open to maintain any of those equilibria in the long run. For the achievement of the one at the expense of another is but transitory, and, hence, is ultimately self defeating.

Since adjustment in the region has been largely recessive, this establishes a prima facie case for short run policy to be biased in favor of utilizing currently underutilized productive capacity, while the longer run effects of policy on investment take hold. However, ordinary aggregate demand

1/ To be sure, for, say, a few months high real interest rates may be needed to help stem capital flight in the midst of an adjustment or stabilization program, while expectations adjust. Yet, if real interest rates need be very high for long, it is a signal that the exchange rate in particular and macro-policy generally, are in doubt. And high interest rates are simply no substitute for credible macro-economic policy.

policies will not do, for these will soon run up against the dearth of foreign exchange to purchase needed intermediate inputs. Hence, it is essential for expansive adjustment that a significant part of the output obtained from this increased capacity utilization be for export; certainly not 100%, but enough to generate the foreign exchange required to utilize the rest of unused capacity for domestic use, both in import substitution as well as in the production of socially needed non-tradeables (e.g., housing).

To do this, an appropriate rule of thumb is to equalize the short run marginal costs of generating or saving foreign exchange via expenditure switching or expenditure reduction policies. Since it can be foreseen that expenditure reduction policies will operate far more quickly than switching policies, heavy and selective switching policies would be called for in the short run. These incentives should, however, be transitory, set in accordance with the degree of currently unused capacity, and limited only to those products with the highest short-term output elasticity to price and those with the best chances of achieving long-term international competitiveness 1/.

In brief, the experience of recent years suggests two types of pitfalls: those deriving from pervasive intervention and a virtual disregard of the market as well as those deriving from overly rapid liberalization and an excessive reliance on the market. At the risk of oversimplification, our analysis suggests the merits of intervention in the short run (while macroeconomic relations are in disequilibrium); and increased reliance on the price system and a few, simple rules of intervention in the latter case being largely limited to attack the two critical bottlenecks (foreign exchange and the savings-investment process) and to achieve distributive objectives.

More generally, we would emphasize the need for sectoral, not just across the board, policy and for selective, and not just general, policy instruments. However, we would also insist on the need for an outward oriented development strategy, export promotion being the natural follow up to the

1/ Once again, the temporary and selective use of such instruments permits incentives to be tailored to those export and import substituting activities with the fastest response in the short run. Selective instruments have the further advantage of having a lesser impact on costs and expectations and hence on inflation than a devaluation. Finally, precisely because these selective instruments should be temporary, the exchange rate can be set for long run equilibrium, thus rendering a clearer and stabler signal to producers as to the objective of policy. Obviously, once the effect of regular switching policies (devaluation) on investment take hold, these transitory superswitching incentives should be phased out.

industrial base created by import substitution. Thus, whereas industrialization based on import substitution was at the heart of regional policy in the past, the reorientation of this established industrial base towards an export oriented industrialization would seem to be the direction of the future for many countries. This would suggest the virtues of combining orthodox goals and instruments (export orientation and devaluation) with their structural counterparts (industrialization and carefully chosen selective incentives).

For those who see the essential policy issue as between more intervention or more markets, such an "unholy alliance" would appear to be a contradiction in terms. For those who see the challenge as to how to achieve better intervention and better markets, this proposal may ring true, as the essence of balance and common sense.

b. External requirements

However effective the design and implementation of domestic adjustment policies, their efficacy is today heavily conditioned by external events. For one, growth-oriented adjustment relies critically on the expansion and diversification of exports. While this certainly depends on domestic economic decisions, especially exchange and commercial policy, it will be easier or more difficult depending on whether the expansion of international trade be brisk or sluggish and whether there be a rebound in the currently depressed level of basic commodity prices or these continue to fall. Not much can be done to reverse depressed demand resulting from structural or technological changes. Yet, much of the sluggish demand for Latin America's exports is due to weak OECD growth, to policy induced artificial surpluses in agricultural commodities and to increased protection generally.

To be sure, there are sectoral interests which OECD authorities must take into account in formulating policies. Nevertheless, it is also clear that these policies must be reconciled with the basic accounting identity that interest payments from debtor countries require equivalent trade deficits in creditor countries or corresponding capital inflows to debtors. If creditors want interest repayment and low capital flows, they must run high trade deficits (hopefully via increased imports from debtors, rather than through reduced exports to them). Alternatively, if creditors want protection and trade surpluses they need to promote capital flows to debtors or else assume the consequences of debt moratoria. In short, creditor countries can have trade surpluses, or receive full interest repayment or refuse to extend new net loans. What is impossible for them is to have all three simultaneously. Hence, the improvement and harmonization of their macroeconomic, sectoral, trade and financial policies is not simply a matter of international "do goodism", but a basic condition for economic equilibria in the center's own external accounts.

Expansionary adjustment also requires time and resources. For the speed with which exports expand and efficient import substitution takes place depends not only on correct relative prices but on the amount of resources actually available for investment. So long as the region must transfer the equivalent of 25% of its savings for these purposes, such investment can hardly

be forthcoming in the appropriate amounts to permit significant trade surpluses and a rapid and sustained rate of economic growth. Hence, if expansionary structural adjustment is to take place, the region's net outward transfer of resources need be sharply reduced.

This can be achieved via lower international interest rates and the return of flight capital, or increased net lending or debt forgiveness. Given the severity and duration of the crisis, it is likely that in many cases solutions will require most of the above.

Lowering interest rates

During the past four years net interest remittances have absorbed around 35% of the total value of the region's exports, which is double the percentage they represented before this crisis. Therefore if these payments were reduced, it would be possible to raise imports significantly without producing any increase in the deficit on current account. Furthermore, if the decline in interest payments were the result of a drop in international interest rates, the reduction in the transfer of resources could be achieved with less pressure on bank profits, and the ensuing reactivation of the economy could be achieved without expanding the external debt. It would therefore have the additional advantage of not jeopardizing future import capacity. In other words, the reduction of international base rates constitutes the less conflictive solution to the debt problem.

Hence, the importance that the recent fall in international interest rates be maintained and strengthened. Yet such a decline, welcome as it is, should not be overrated, for the sharp decline that took place in 1985-86 was in nominal interest rates while real rates fell much less. Yet what is required is that real interest rates decline; only if nominal interest rates fall more than inflation will total interest payments decline in relation to the region's capacity to pay them (which depends on exports, whose value tends to rise and fall with world inflation). In contrast, as long as real interest rates persistently remain higher than the growth rate of output, and nominal interest rates remain higher than the growth rate of export earnings, there is a progressive risk that debtor countries will drift into insolvency.

But the reduction of interest rates depends ultimately on neither debtors nor creditors, but on the policies of the principal industrialized countries. This is an example --possibly the example par excellence-- of why a satisfactory resolution of the debt crisis cannot be found within the limited confines of debtors and creditors, but depends strongly on the public policy of industrialized countries as well. Thus industrialized countries must more decisively tackle their own internal adjustment problems, because without it the world-wide adjustment process is asymmetric, and places an unnecessarily large burden on the developing country debtors.

Reversing Capital Flight

As mentioned earlier, the region, and some countries more especially, have experienced a large amount of capital flight. This is reflected in the fact that towards the end of 1985, Latin American residents had \$83 billion deposited in the international banking system, more than 2.5 times the level of the region's official gross international reserves. The reduction of the outward transfer of resources and a growth oriented adjustment process would clearly be facilitated if most of this capital began to return to the region. This, of course, would be another non-conflictive way of reducing the debt problem and easing the adjustment process.

Both the outflow of this capital and its return depend heavily on the nature of macro-economic policy and political conditions in the debtor countries. For a return to be effected, good macro-policy must be sustained and rates of return must rise on productive investments. There also must be political stability and guarantees for the security of private capital. That this is a possible and not just a theoretical option is demonstrated by the fact that some countries such as Mexico, Chile and Uruguay were able to stop the capital outflow and even partially reverse it in 1986. However, it is unlikely that in most countries the amounts be very large, at least until this critical juncture of the debt crisis be over, given flight capital's tendency to be first out, last in.

Increasing Net Lending

An alternative and complement to lower interest rates and the return of flight capital is more lending. The less interest rates fall for the debtor countries, the more new lending is required from the creditors to reduce the outward financial transfer and support dynamic and socially efficient adjustment.

At the outset of 1986 there was a surprising consensus about what constituted a conservative estimate of Latin America's financing needs to support a growth-oriented adjustment process: roughly \$20 billion per year for annual growth rates of 4-5% per year ^{1/}. This compares with actual net capital inflows of \$2 billion and \$9 billion in 1985 and 1986, respectively.

1/ The \$20 billion figure was cited in early 1986 in separate reports of the World Bank, ECLAC, and the Inter-American Dialogue. The ECLAC report, however, did not take into account the net effect of the sharp fall in petroleum prices in early 1986. The timing of the two other reports suggests that they could not incorporate this effect either. Since Latin America is a net petroleum exporter, annual financing requirement may in fact be higher than \$20 billion. See ECLAC *The Problem of External Debt: Gestation, Development, Crisis and Prospects*, Santiago, Chile, January 1986; Inter-American Dialogue, *Rebuilding Cooperation in the Americas*, Washington D.C., April 1986 and David Knox, "Address at the Bankers Club", Tokyo, 20 February 1986.

As already mentioned, private banks have demonstrated in recent years a great reluctance to lend to Latin America. More concerted non-voluntary lending to Latin America is unattractive for many banks since they want to further reduce their asset/capital ratios in the region. Moreover the bank's ability to resist new lending has been enhanced by loan writeoffs and growth of loan loss reserves. That resistance can be especially strong in European institutions which are often obliged to set aside new reserves for any additional dollar lent. This situation will put increased pressure on public lenders, which so far do not have adequate resources to fill the expected gap.

Nevertheless, to the degree that the debtor country has the necessary underlying economic conditions to support its commercial debt --or merits the benefit of the doubt-- a violent pull-back of new lending by the banks constitutes a certain degree of myopia on the part of private markets. This is where public policy in the OECD can legitimately employ strong moral persuasion to "encourage" private lenders to stay in the game and support the financing of a dynamic adjustment process with new loans. The required financing can come about directly by the authorization of new credits or indirectly through the semi-automatic capping of interest rates (which, of course, should be commercial) and the rescheduling of amortization. The creditors would have to commit themselves to an annual financial transfer that subordinates itself to the requirements of a growth oriented adjustment program, as banks themselves have in fact accepted in the recent Mexican package, for which new financing adjusts itself to the need to support a 3-4% rate of economic growth in that country.

Debt Forgiveness

While new lending to the borrowers in whatever form is perhaps better than no finance at all, commercial reschedulings and new loan packages are not technically appropriate for all of them. There are countries where the debt overhang is large due either to the past willingness of lenders and borrowers to create debt largely for purposes which had little prospect of generating a commercial return and/or to possibly permanent adverse shifts in the debtor's terms of trade. In either case the country's economic structure needs thorough and time consuming overhaul, before internal rate of returns will be high enough to support a commercial interest rate. Consequently, for these countries, adjustment promises to be unusually protracted and the prospects of regaining autonomous access to private credit markets in the foreseeable future and remote. They are analogous to an insolvent commercial borrower and some form of non-commercial debt relief, with hidden or explicit debt forgiveness, is appropriate.

The market already admits to the problem because as soon as Latin American paper is subject to competitive trade, an automatic discount materializes. Although the secondary trading market is thin and its valuation of paper may not be entirely reliable, any discount above a third of face value is suggestive of a problem loan. For these countries, continuing insistence on commercial returns for loans of non-commercial value only burdens the adjustment process and leaves open the prospects of permanently high and rising debt/export

and debt/GDP coefficients in the debtor country. It also involves wishful accounting in the banks and undermines the strength of the home country banking system.

The form debt forgiveness take --non commercial interest rates or partial cancellation of principal-- would vary from country to country and ideally should be done as painlessly as possible for banks. Yet it is clear at this stage, after five years of adjustment, that countries with very severe and protracted additional adjustment problems will need some form of debt forgiveness.

Of course, debt forgiveness represents a cost for the creditors. Nevertheless, this organized and predictable financial cost must be weighed against other costs such as loss of export markets and jobs in the creditor countries as well as the potential and unpredictable financial costs deriving from the risk of disorderly defaults by the debtor countries.

To be sure, while banks do write down loans (as many have done to date) or even write them off fully, there is no incentive for them to forgive a debt. And so the menace of the debt crisis continues. The problem then is how to translate the costs of debt writeoffs to banks into equivalent benefits for debtors. Since the debt problem is by now a systemic one, and the object of OECD governments should be, at least, to minimize the disrupture on the international financial systems of spasmodic moratoria on the part of problem debtor nations, creditor governments should now act to minimize this eventuality and push for concerted debt forgiveness. And certainly there are precedents for this. Debt forgiveness by banks, often with their governments' help and cost sharing, is frequently practiced in the domestic markets of the creditors. Recently there have been a number of measures introduced providing debt forgiveness on problem farm loans, with the appropriate accounting flexibility for the lenders. Why not practice internationally principles that already are considered appropriate for systemic debt problems at home?

Conclusions

By and large, most countries of the region reacted to the post-1979 crisis initially putting off domestic adjustment policies and then, overadjusting. The first was ineffective; the latter, inefficient. In the former, because domestic policies failed to adjust while financing was available, thus achieving short-term growth at the expense of worsened external disequilibria; in the latter, because financing collapsed. Thus, though domestic policies adjusted, the improvement in external accounts was obtained at the expense of economic growth.

For an efficient adjustment process requires better domestic policies together with adequate financing. The first assures its permanence, the latter wins valuable time for the needed structural transformations to take hold. Efficient adjustment requires not only expenditure reduction and import compression --which can be as sharp as desired--, but a reallocation of real resources from non-tradeables to exports and imports substitution --which is necessarily a slower process. In short, there is no such thing as an efficient shock adjustment program.

In any case, the dramatic improvement in external accounts which had been achieved by 1984 at the expense of costly reductions in output, employment and wages, was seriously setback in 1986, in large part due to the fall in the prices of oil and other basic commodities. Hence, debt indicators deteriorated markedly in most countries of the region, implying the need for more prolonged, if not more pronounced, adjustment.

In addition, because of the length and severity of the crisis, adjustment weariness has set in among debtors and debt fatigue among creditors. The former are unable to postpone growth any longer; the latter want to supply little, if any, new money. In the face of such an impasse, a scenario which could ultimately lead to spasmodic moratoria, which would jeopardize not just particular creditors and debtors but the international financial and open trading system as well, cannot be discarded.

To break this impasse and reconcile growth and creditworthiness, concerted action by all parties involved is now essential. Debtor countries --which up to the present have shouldered a disproportionate amount of the burden of adjustment-- must persist in their efforts to restructure their economies. In return, and, to make this process both economically efficient and politically viable, private creditors, their governments, and official lenders must provide finance far above present levels, thus restoring symmetry to the adjustment process.

In some ways this resembles the Baker Initiative. But there are important differences. On the one hand, the content of adjustment policy which we have outlined is more selective in the use of policy instruments, more pragmatic with regard to the role of state intervention, and more directly concerned about social questions of equity. On the other, we stress that while commercial solutions are acceptable for some problem borrowers, some degree of debt forgiveness is unavoidable for others.

STATISTICAL TABLES

Table 1

THE EFFECT OF THE DETERIORATION OF UNIT PRICES OF NON PETROLEUM
EXPORTS AND OF THE RISE IN INTERNATIONAL INTEREST
RATES ON LATIN AMERICA'S CURRENT
ACCOUNT BALANCE

(Billions of US\$)

Deficit in current account arising from:				

Export prices (excluding oil) below 1950-70 average in real terms	LIBOR above historic rate in real terms (2%)	Actual current account balance	Counterfactual current account balance without deterioration in export prices or rise in interest rates	
(1)	(2)	(3)	4=(3)-(1)-(2)	

1981	4.7	5.4	-40.5	-30.4
1982	9.8	7.5	-40.6	-23.3
1983	12.8	6.8	-7.4	12.2
1984	10.8	8.6	-0.2	19.2
1985	11.7	5.0	-4.0	12.7
1986	8.5	7.0	-14.2	1.3

Source: Calculated on the basis of ECLAC's balance of payments series.

Table 2

LATIN AMERICA: MAIN ECONOMIC INDICATORS

	1980	1981	1982	1983	1984	1985	1986
<u>I. Indexes (1980=100)</u>							
1. Gross domestic product	100.0	100.5	99.0	96.6	99.8	102.4	105.9
2. Per capita gross domestic product	100.0	98.1	94.5	90.1	90.9	91.3	92.4
3. Per capita national income	100.0	96.5	89.8	85.6	86.7	86.7	...
4. Terms of trade	100.0	94.0	85.2	85.6	90.1	85.6	78.1
Exports of goods							
5. Value	100.0	107.6	98.1	98.2	109.6	103.1	87.8
6. Volume	100.0	108.5	110.2	119.8	130.6	130.6	127.3
7. Purchasing power of exports of goods	100.0	101.9	94.2	104.6	118.5	112.8	101.9
Imports of goods							
8. Value	100.0	108.1	86.6	61.9	64.4	64.6	66.2
9. Volume	100.0	102.6	83.4	65.5	70.7	71.7	76.7
<u>II. Growth Rates</u>							
10. Gross domestic product	5.3	0.5	-1.4	-2.4	3.2	2.7	3.4
11. Per capita gross domestic product	2.8	-1.9	-3.7	-4.7	0.9	0.4	1.2
12. Per capita national income	3.6	-3.5	-6.9	-5.1	1.4	0.0	...
13. Consumer prices	56.1	57.6	84.8	131.1	185.2	275.3	69.1
14. Current value of exports of goods	32.2	7.6	-8.8	0.1	11.7	-5.9	-14.8
15. Current value of imports of goods	34.9	8.1	-19.8	-28.5	4.0	0.3	2.4
16. Terms of trade	4.3	-5.8	-9.0	1.1	6.5	-5.0	-8.7
17. Purchasing power of exports of goods	10.3	1.9	-7.6	10.1	13.3	-4.8	-9.7
<u>III. Billions of dollars</u>							
<u>Balance of payments</u>							
18. Current account balance	-28.3	-40.3	-41.0	-7.6	-0.2	-4.0	-14.2
19. Merchandise trade balance	-1.3	-1.9	9.1	31.5	39.4	33.5	18.4
20. Exports	89.1	95.9	87.4	87.5	97.7	92.0	78.3
21. Imports	90.4	97.6	78.3	55.0	58.3	58.5	59.9
22. Factor payments	17.9	27.2	38.7	34.3	36.2	35.3	30.7
23. Capital account balance	29.4	37.5	20.0	3.2	9.2	2.4	8.6
24. Global balance	1.4	-2.8	-21.0	-4.4	9.0	-1.6	-5.6
25. Net transfer of resources	11.5	10.4	-18.7	-31.2	-27.0	-32.9	-22.1
26. Gross external debt	230.4	287.8	330.7	350.8	366.9	373.2	382.1
<u>IV. Percentages</u>							
27. Current account deficit/total exports	26.0	34.7	39.8	7.4	0.2	3.7	15.7
28. Net transfer of resources/total exports	10.7	9.0	-18.1	-30.5	-23.7	-30.2	-23.2
29. Interest payments/total exports	20.2	28.0	41.0	36.0	35.6	35.2	35.1
30. External debt/total exports	214	248	321	343	322	342	401

Source: ECLAC, on the basis of official data.

Table 3

LATIN AMERICA: RELATIONSHIP BETWEEN THE TRADE BALANCE
AND TOTAL INTEREST PAYMENTS a/
(Percentages)

	1980	1981	1982	1983	1984	1985	1986 ^{b/}
<u>Latin America</u>	<u>-46.9</u>	<u>-39.0</u>	<u>-3.0</u>	<u>74.8</u>	<u>88.7</u>	<u>80.0</u>	<u>46.2</u>
Latin America without Brazil	-28.9	-50.1	5.5	88.8	84.5	72.8	27.4
Oil-exporting countries <u>c/</u>	39.6	-14.5	19.4	139.3	126.8	99.6	25.6
Non-oil exporting countries <u>d/</u>	-106.8	-56.5	-21.2	23.6	58.0	64.9	60.4
Argentina	-146.7	-19.7	54.1	63.9	58.0	84.8	48.8
Brazil	-79.6	-16.3	-22.3	39.7	99.1	97.0	88.0
Colombia	-20.0	-184.2	-197.8	-194.9	-16.2	-26.6	76.6
Costa Rica	-212.5	-38.6	18.1	-4.3	-5.0	-28.5	6.5
Chile	-91.6	-167.0	-16.5	35.0	-6.5	26.2	31.2
Ecuador	-11.1	-29.6	-25.0	101.7	69.1	98.2	20.0
Mexico	-40.6	-55.6	50.9	40.9	118.8	89.8	43.0
Peru	102.7	-89.6	-72.5	3.5	62.1	86.4	-19.5
Uruguay	-367.9	-180.5	-14.0	62.0	49.7	54.7	100.0
Venezuela	300.0	144.3	-56.2	196.9	205.0	136.7	-0.9

Source: ECLAC, on the basis of official figures.

a/ Trade balance in goods and services.

b/ Preliminary figures.

c/ Includes Bolivia, Ecuador, Mexico, Peru and Venezuela.

d/ Includes Argentina, Brazil, Colombia, Costa Rica, Chile, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Paraguay, Dominican Republic and Uruguay.

Table 4

LATIN AMERICA : EVOLUTION OF REAL WAGES a/
(Percentage variation)

	1981	1982	1983	1984	1985	cumulative variation during	
						present crisis <u>b/</u>	former decade
Argentina	-10.6	-10.4	25.5	26.4	-15.2	7.8	-6.9
Brazil	8.5	12.1	-7.3	-6.7	7.1	12.6	55.5
Colombia	1.4	3.4	5.2	7.4	-2.9	13.4	-0.6
Costa Rica	-11.7	-19.8	10.9	7.8	8.9	-7.8	31.6
Chile	9.1	-0.4	-10.6	0.3	-4.5	-14.8	-0.8
Ecuador	-13.8	-11.9	-16.2	-1.3	-3.2	-39.2	15.2
Mexico	3.6	0.8	-22.7	-6.2	1.2	-26.1	15.4
Peru	-1.7	2.3	-16.8	-15.2	-15.3	-38.9	-13.9
Uruguay	7.5	-0.3	-20.7	-9.2	14.1	-18.1	-50.2

Source : ECLAC, on the basis of official information.

a/ Average real wages in urban activities (Costa Rica, Chile and Uruguay) or in industry (Argentina, Brazil, Colombia, Mexico and Peru). Real minimum wages in urban area for Ecuador.

b/ Since the crisis did not begin simultaneously in all the countries included, cumulative variations have been calculated over different periods in order to reflect the impact of adjustment on real wages more accurately. Figures in this column thus show the variation registered between 1980 and 1985 for Argentina, Brazil, Costa Rica and Ecuador; and between 1981 and 1985 for Colombia, Chile, Mexico, Peru and Uruguay.

Table 5

INDICES OF FINANCIAL VULNERABILITY AND TRADE
FLEXIBILITY AT THE ONSET OF THE CRISIS
(1980-81): SELECTED LATIN AMERICAN
AND ASIAN COUNTRIES
(Percentages)

	Financial Vulnerability		Trade Flexibility		
	(1)	(2)	(3)	(4)	(5)
	% Debt at Floating Rates	Interest <u>Payments</u> Exports	<u>Exports</u> GDP	<u>Exports</u> Tradeables a/	Basic Commodity <u>Exports</u> b/ Total Exports
<u>Latin America</u>	<u>64.5</u>	<u>28.0</u>	<u>13</u>	<u>27</u>	<u>76</u>
Argentina	58.3	15.1	7	15	79
Brazil	64.3	28.3	9	19	60
Colombia	39.2 c/	16.3	15	26	76
Costa Rica	49.3	12.6	35	71	67
Chile	58.2 c/	28.2	20	47	85
Ecuador	50.5 c/	21.3	23	45	97
Mexico	73.0	19.0	14	30	61
Peru	28.0 c/	19.8	21	40	84
Uruguay	33.5 c/	12.0	12	29	66
Venezuela	81.4 c/	10.4	32	62	98
South Korea	33.3	6.2	38	67	10
Taiwan	...	<5.0	52	..	14

Source: ECLAC, Preliminary Balance of the Latin American Economy 1986 (Dec. 1986); World Bank, World Development Report various years; and G. Ranis, "East Asia and Latin America: Contrasts in the Political Economy of Development Policy Change" (mimeo, May 1986); and J. Fei, G. Ranis, and S. Kuo, Growth with Equity: the Taiwan Case (World Bank, 1979).

a/ Agriculture, mining and manufacturing.

b/ Fuels, minerals, metals and other agricultural commodities.

c/ 1980-82.

Table 6
INTERNATIONAL RATES OF INTEREST, NOMINAL AND REAL
(Percentages)

	Nominal LIBOR <u>a/</u>	Percentage variation in		Real LIBOR (1) / (2)	Real LIBOR (1) / (3)
	(1)	Consumer prices industrialized countries	Unit price of exports of Latin America	(4)	(5)
1970	8.47	5.6	8.1	2.7	0.3
1971	6.79	5.2	1.9	1.5	4.8
1972	5.41	4.7	9.2	0.7	-3.5
1973	9.31	7.7	33.0	1.5	-17.8
1974	11.20	13.3	57.5	-1.9	-29.4
1975	7.61	11.1	-5.7	-3.1	14.1
1976	6.12	8.3	8.1	-2.0	-1.8
1977	6.42	8.4	10.6	-1.8	-3.8
1978	8.33	7.2	-3.7	1.1	12.5
1979	11.99	9.2	21.0	2.6	-7.4
1980	14.15	11.2	21.2	2.0	-5.8
1981	16.52	9.9	-2.8	6.0	19.9
1982	13.25	7.5	-11.2	5.3	27.5
1983	9.79	5.0	-6.5	4.6	17.4
1984	11.20	4.8	2.6	6.1	8.4
1985	8.64	4.2	0.6	4.3	9.3
1986	6.71	1.8	-12.7	4.8	22.2

Source: ECLAC, on the basis of data in Morgan Guaranty Trust, World Financial Markets and IMF, International Financial Statistics.

a/ 180 days.

Table 7

LATIN AMERICA: RATIO OF TOTAL INTEREST PAYMENTS TO
EXPORTS OF GOODS AND SERVICES a/
(Percentages)

Country	1978	1979	1980	1981	1982	1983	1984	1985	1986 ^{b/}
<u>Latin America</u>	<u>15.7</u>	<u>17.6</u>	<u>20.2</u>	<u>28.0</u>	<u>41.0</u>	<u>36.0</u>	<u>35.6</u>	<u>35.2</u>	<u>35.1</u>
Oil-exporting countries <u>c/</u>	16.1	15.7	16.6	22.6	35.6	31.4	32.5	32.3	36.5
Non-oil exporting countries <u>d/</u>	15.5	19.3	23.7	33.6	46.7	40.7	38.7	37.9	34.2
Argentina	9.6	12.8	22.0	35.5	53.6	58.4	57.6	51.1	51.8
Brazil	24.5	31.5	34.1	40.4	57.1	43.5	39.7	40.0	37.7
Colombia	7.5	9.9	11.8	21.9	25.9	26.7	22.8	26.3	18.6
Costa Rica	9.9	12.8	18.0	28.0	36.1	33.0	26.6	27.3	22.7
Chile	16.9	16.5	19.3	38.8	49.5	38.9	48.0	43.5	39.2
Ecuador	10.4	13.6	18.3	24.3	30.0	27.4	30.7	27.0	32.2
Mexico	24.0	24.5	23.3	29.0	47.3	37.5	39.0	36.0	40.0
Peru	21.2	15.5	16.0	24.1	25.1	29.8	33.2	30.0	27.3
Uruguay	10.4	9.0	11.0	12.9	22.4	24.8	34.8	34.2	23.8
Venezuela	7.2	6.9	8.1	12.7	21.0	21.6	20.1	26.3	33.3

Source: 1978-1986: ECLAC, on the basis of official data.

a/ Interest payments include those on the short-term debt.

b/ Preliminary estimates subject to revision.

c/ Includes Bolivia, Ecuador, Mexico, Peru and Venezuela.

d/ Includes Argentina, Brazil, Colombia, Costa Rica, Chile, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Paraguay, Dominican Republic and Uruguay.

Table 8

LATIN AMERICA: NET INFLOW OF CAPITAL AND
TRANSFER OF RESOURCES
(Billions of dollars and percentages)

Year	Net inflow of capital	Net payments of profits and interests	Transfers of resources		Exports of goods and services	Transfers of resources/ exports of goods and services ^{a/} (5) = (3)/(4)
			(3) = (1)	(2)		
	(1)	(2)	(3)	(4)	(5)	
1973	7.9	4.2	3.7		28.9	12.8
1974	11.4	5.0	6.4		43.6	14.7
1975	14.3	5.6	8.7		41.1	21.2
1976	17.9	6.8	11.1		47.3	23.5
1977	17.2	8.2	9.0		55.9	16.1
1978	26.2	10.2	16.0		61.3	26.1
1979	29.1	13.6	15.5		82.0	18.9
1980	29.4	17.9	11.5		107.6	10.7
1981	37.5	27.1	10.4		116.1	9.0
1982	20.0	38.7	-18.7		103.2	-18.1
1983	3.2	34.3	-31.2		102.4	-30.5
1984	9.2	36.2	-27.0		114.1	-23.7
1985	2.4	35.3	-32.9		109.0	-30.2
1986 ^{b/}	8.6	30.7	-22.1		95.2	-23.2

Source: 1973-1985: ECLAC, on the basis of data supplied by the IMF. 1986: ECLAC, on the basis of official figures.

^{a/} Percentages.

^{b/} Preliminary estimates subject to revision.

Table 9

COMPARISON OF LATIN AMERICA'S REGISTERED NET OUTWARD
TRANSFER OF FINANCIAL RESOURCES ON FOREIGN
CAPITAL WITH THE WAR REPARATIONS
OF FRANCE AND GERMANY a/

(Percentages)

	<u>Transfer</u> GDP b/	<u>Transfer</u> Exports c/	<u>Transfer</u> Domestic savings
France 1872-1875 d/	5.6	30.0	...
Germany 1925-1932 e/	2.5	13.4	...
Latin America 1982-1985 f/	4.2	25.7	18.7
Argentina	6.0	41.4	31.0
Brazil	2.9	24.2	13.7
Colombia	-0.3	-2.8	-1.8
Costa Rica	-0.3	-1.2	-1.7
Chile	3.3	14.2	18.6
Ecuador	4.5	19.6	16.9
Mexico	7.9	42.1	28.5
Peru	0.8	4.6	3.2
Uruguay	5.3	20.8	30.6
Venezuela	9.3	33.6	34.2

Sources: Germany and France: calculated from data in Fritz Machlup, International Payments, Debt and Gold (N.Y.: New York University Press, 1976); and Helmut Reisen, "The Latin American Transfer Problem in Historical Perspective", in OECD, Latin American and the Caribbean and the OECD, Paris, 1986. Latin America: Estimated on the basis of ECLAC's balance of payments and national income data series.

a/ In view of the dates of the German and French cases, data should be viewed with appropriate caution and taken as estimates of rough orders of magnitude.

b/ The denominator is national income in the case of Germany and France and GDP in the case of Latin America. Note that GDP is larger than national income for debtor nations.

c/ Presumably goods for France and Germany. Goods and services for Latin America.

d/ War reparations of Fr 5.000 million as part of the 1871 peace treaty of Frankfurt which ended the Franco-Prussian War.

e/ War reparations to victorious nations of RM 10.720 million in currency and payments in kind as formulated in the 1919 Treaty of Versailles.

f/ Net inflow of capital less net payments of profits and interests.

Table 10

ACCUMULATED TRADE SURPLUS OF GERMANY, FRANCE AND
LATIN AMERICA DURING PERIODS OF
NON VOLUNTARY TRANSFERS a/

(Percentages)

	As percent of income b/		As percent of exports c/	
	Trade surplus in goods	Trade surplus in goods and services	Trade surplus in goods	Trade surplus in goods and services
France 1872-1875	2.3	...	12.3	...
Germany 1925-1928	-	-	-	-
1929-1932	2.5	...	13.8	...
Latin America 1982-1985	4.3	3.5	31.1	21.4
Argentina	5.9	5.6	48.0	38.1
Brazil	3.7	2.7	34.6	22.9
Colombia	-2.8	-3.6	-25.0	-25.7
Costa Rica	-0.4	-0.3	-1.5	0.7
Chile	2.6	0.8	14.3	3.7
Ecuador	6.6	4.5	32.2	19.7
Mexico	7.0	7.3	46.8	39.3
Peru	2.3	1.2	15.8	6.8
Uruguay	4.6	2.9	23.7	11.4
Venezuela	11.2	7.2	43.3	26.0

Sources: Germany and France: Calculated from data in Fritz Machlup, International Payments, Debt and Gold (N.Y.: New York University Press, 1976); and Helmut Reisen, "The Latin American Transfer Problem in Historical Perspective", in OECD, Latin American and the Caribbean and the OECD, Paris, 1986, pp.148-154. Latin America: Estimated on the basis of ECLAC's balance of payments and national income data series.

a/ In view of the dates of the German and French cases, data should be viewed with appropriate caution and taken as estimates of rough orders of magnitude.

b/ In the case of Germany and France the denominator is national income and in the case of Latin America it is GDP. For a debtor nation GDP is normally higher than national income.

c/ In the first column exports are measured in goods and in the second column in goods and services.

Table 11

LATIN AMERICA: SELECTED TRADE INDICATORS
(Coefficients)

	Variations in 1982-1986 in			1982-85	1986	
	X value	X volume	X value	Effect of change in the terms of trade	Net interest	Net interest
	X volume	real effective exchange rate	real effective exchange rate		X in current prices	X in 1980 prices
				Net interest payments		
<u>Latin America</u>	<u>70.4</u>	...	...	<u>-72.6</u>	<u>35.1</u>	<u>24.2</u>
Oil-exporting countries	53.9	...	...	-63.6	36.1	19.9
Non-oil exporting countries	85.5	...	...	-78.9	34.5	27.6
Argentina	68.5	77.9	54.1	-78.0	58.6	37.2
Brazil	86.7	111.7	97.4	-69.0	36.7	29.8
Colombia	118.1	111.5	131.9	-37.1	19.3	20.2
Costa Rica	106.7	113.6	134.5	-99.4	25.0	24.0
Chile	74.2	88.1	66.6	-93.6	39.4	25.2
Ecuador	55.1	93.0	51.2	-65.5	36.0	19.4
Mexico	61.6	74.3	41.8	-74.9	47.5	26.6
Peru	67.2	116.4	77.9	-69.7	31.3	21.0
Uruguay	78.0	77.8	60.5	-122.1	27.4	20.3
Venezuela	47.6	94.5	45.0	-4.1	18.4	9.2

Source: Calculated from data in the balance of payments series prepared by ECLAC.

Table 12

DEBT BURDEN, DOMESTIC EFFORT AND EFFORT OR
FINANCING STILL REQUIRED AS OF 1986 a/
(Percentages)

	(1)	(2)	(3)
	Debt burden	Domestic effort	Effort to be made
	i/GDP <u>b/</u>	TS/GDP <u>c/</u>	and/or further
	(1)	(2)	financing needed
			(3)=(1)-(2)
<u>Latin America</u>	<u>5.3</u>	<u>2.3</u>	<u>3.0</u>
Argentina	6.5	3.2	3.3
Brazil	4.0	3.2	0.8
Colombia	3.0	2.3	0.7
Costa Rica	9.1	2.4	6.7
Chile	8.4	2.6	5.8
Ecuador	5.8	1.2	4.6
Mexico	5.7	2.5	3.2
Peru	3.9	-0.6	4.5
Uruguay	6.5	6.5	0.0
Venezuela	5.3	-0.1	5.4

Source: Estimated on the basis of ECLAC's balance of payments and national accounts series.

a/ Preliminary estimates.

b/ i/GDP = net interest payments on foreign debt as a percentage of gross domestic product.

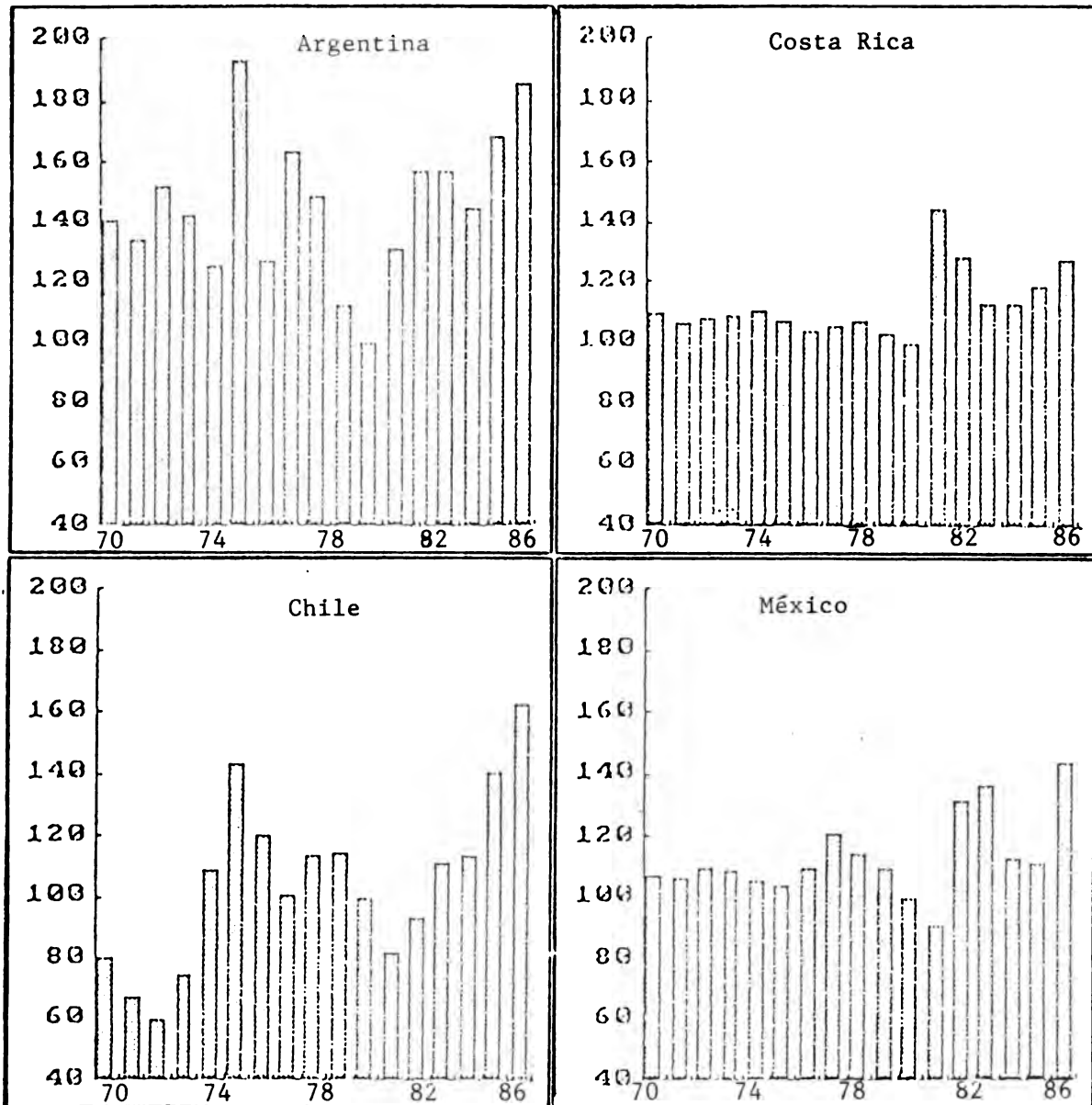
c/ TS/GDP = trade surplus in goods and services as a percentage of gross domestic product.

FIGURES

Figure 1

ANNUAL REAL EFFECTIVE EXCHANGE RATES INDICES IN
SELECTED LATIN AMERICAN COUNTRIES

(1980=100)



Source: ECLAC

Figure 1 (conclusion)

ANNUAL REAL EFFECTIVE EXCHANGE RATES INDICES IN
SELECTED LATIN AMERICAN COUNTRIES

(1980=100)

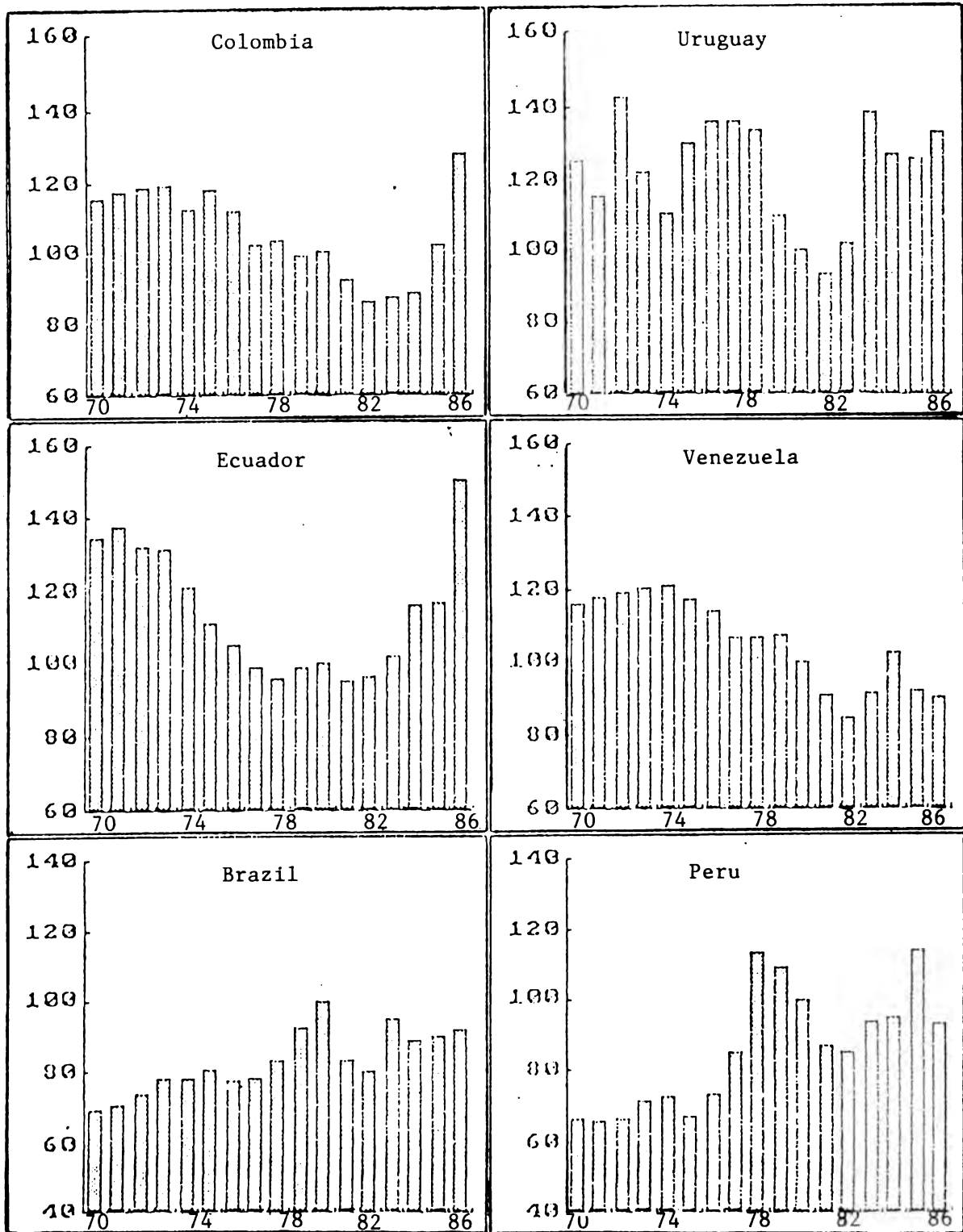
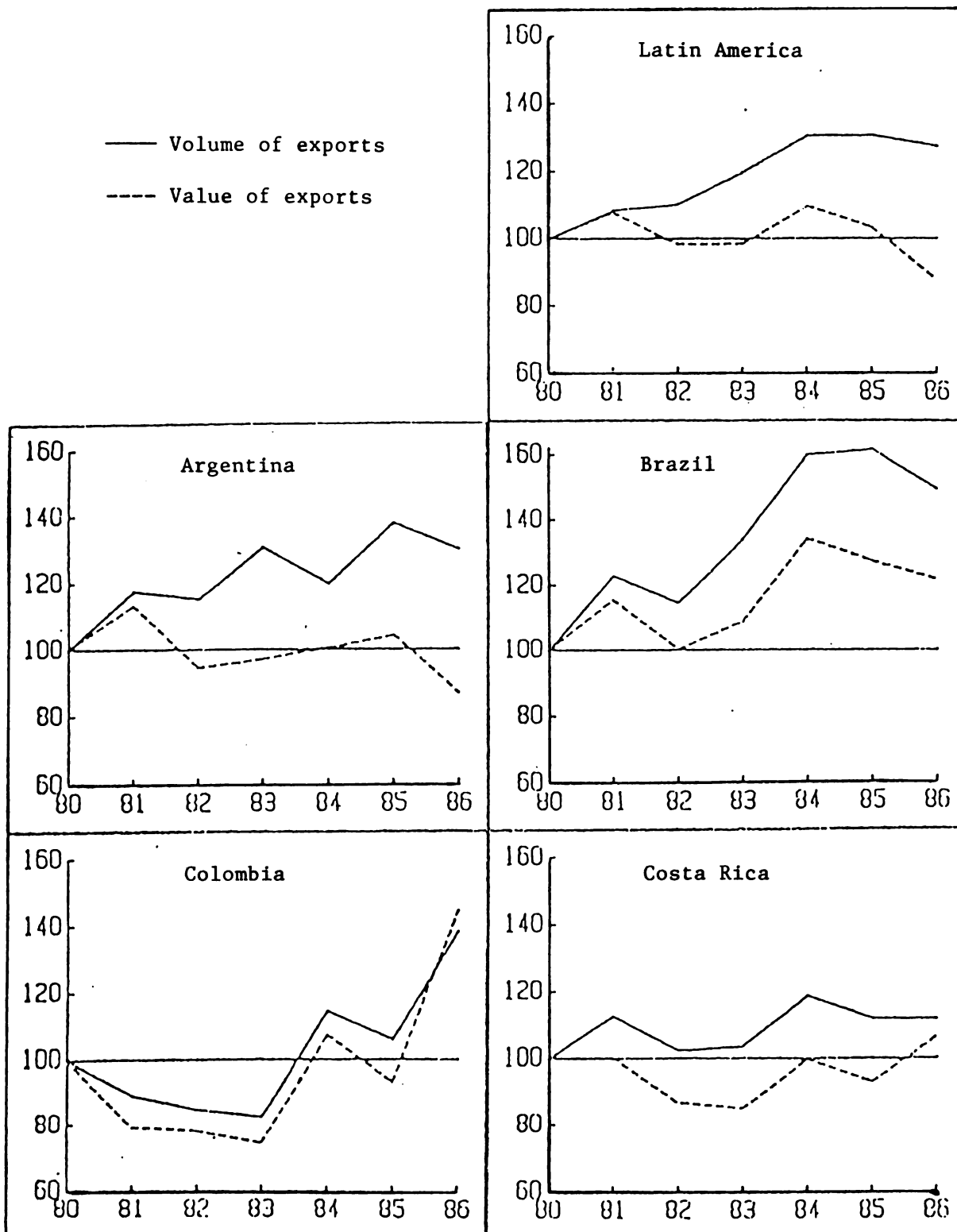


Figure 2

VOLUME AND VALUE OF EXPORTS IN SELECTED
LATIN AMERICAN COUNTRIES

(1980=100)



Source: ECLAC

Figure 2 (conclusion)

VOLUME AND VALUE OF EXPORTS IN SELECTED
LATIN AMERICAN COUNTRIES

(1980=100)

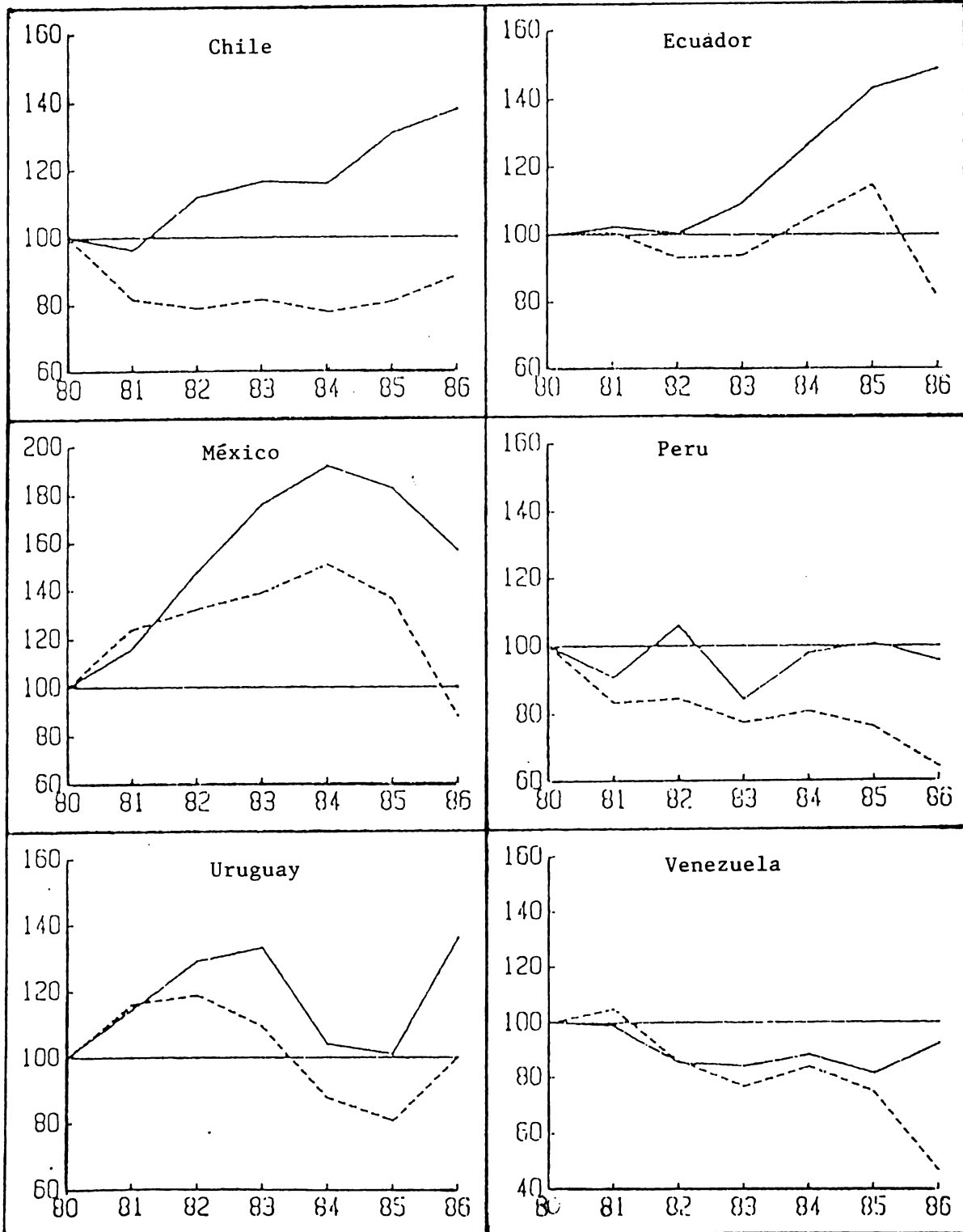


Figure 3

INVESTMENT AND SAVINGS RATIOS IN
SELECTED LATIN AMERICAN COUNTRIES

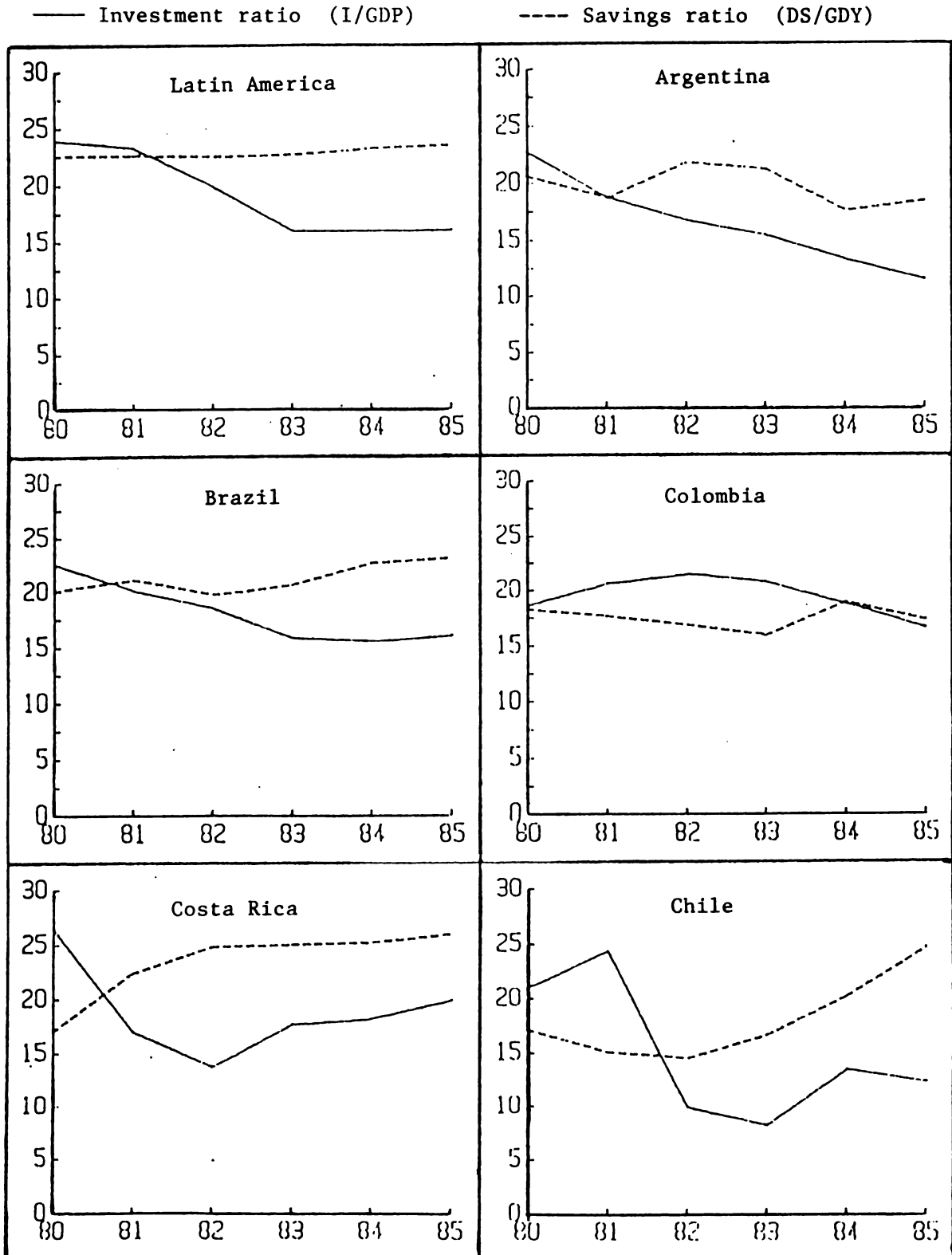


Figure 3 (conclusion)

INVESTMENT AND SAVINGS RATIOS IN
SELECTED LATIN AMERICAN COUNTRIES

— Investment ratio (I/GDP)

---- Savings ratio (DS/GDY)

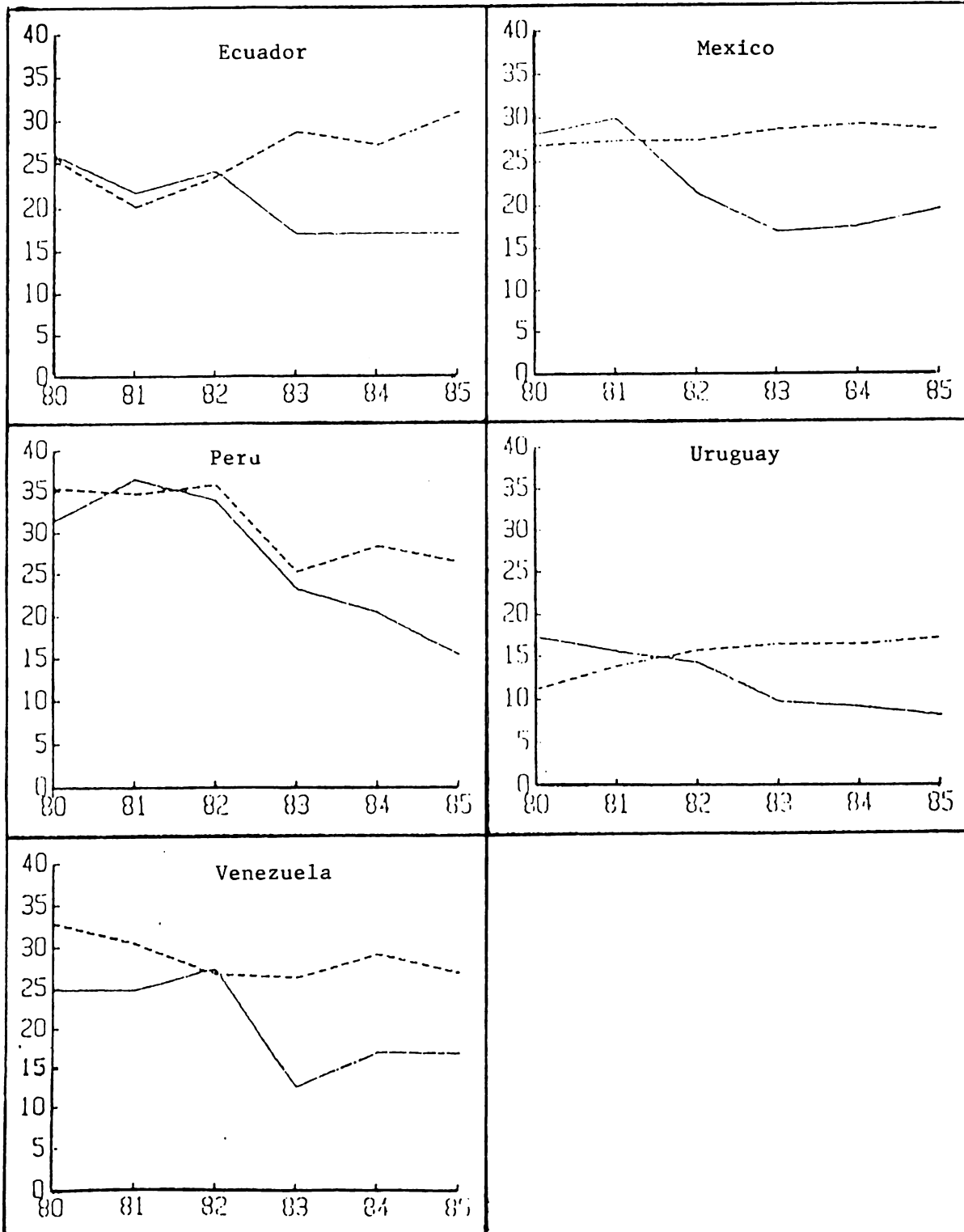
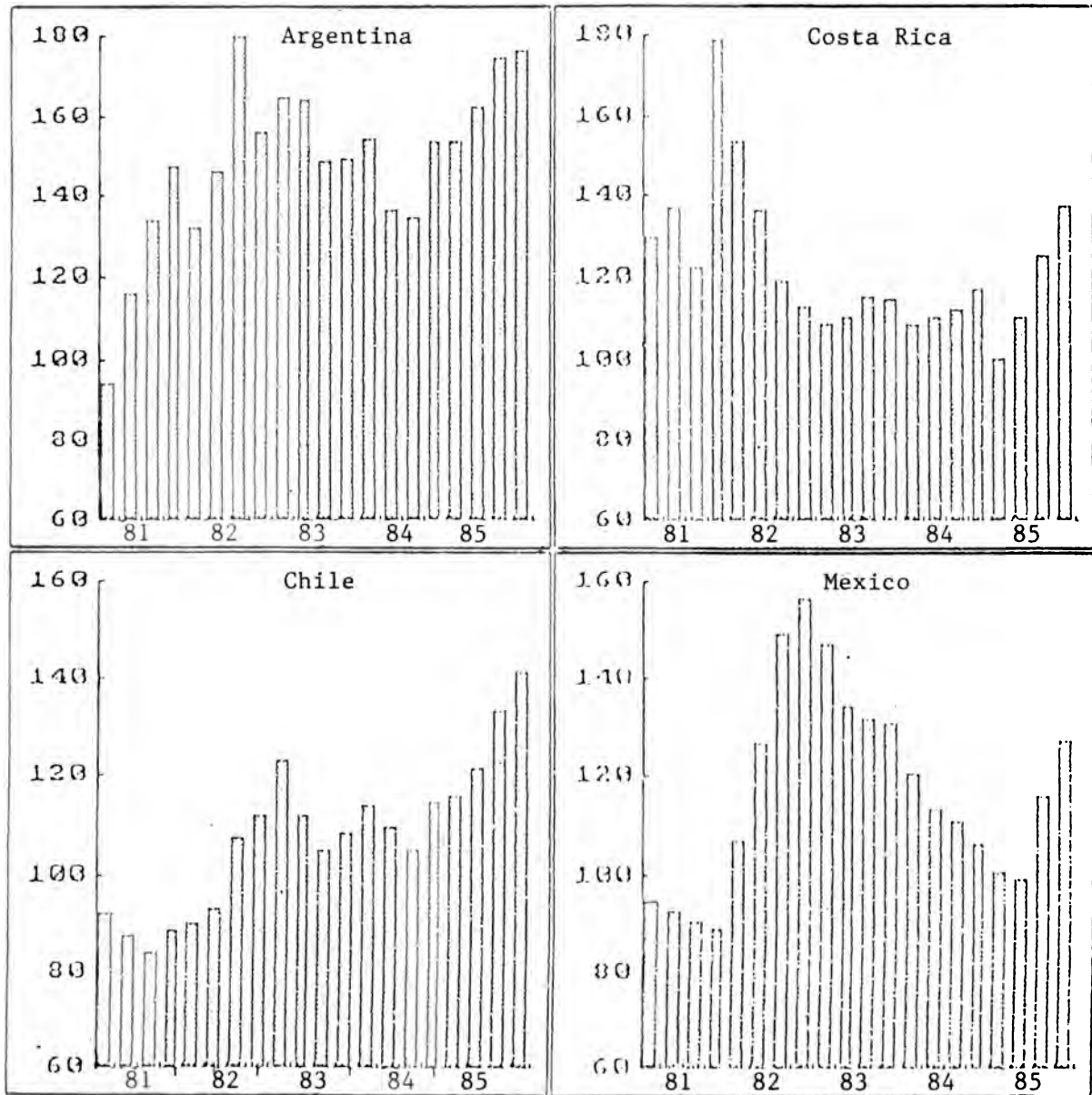


Figure 4

QUARTERLY REAL EFFECTIVE EXCHANGE RATE INDICES
IN SELECTED LATIN AMERICAN COUNTRIES

(1980=100)

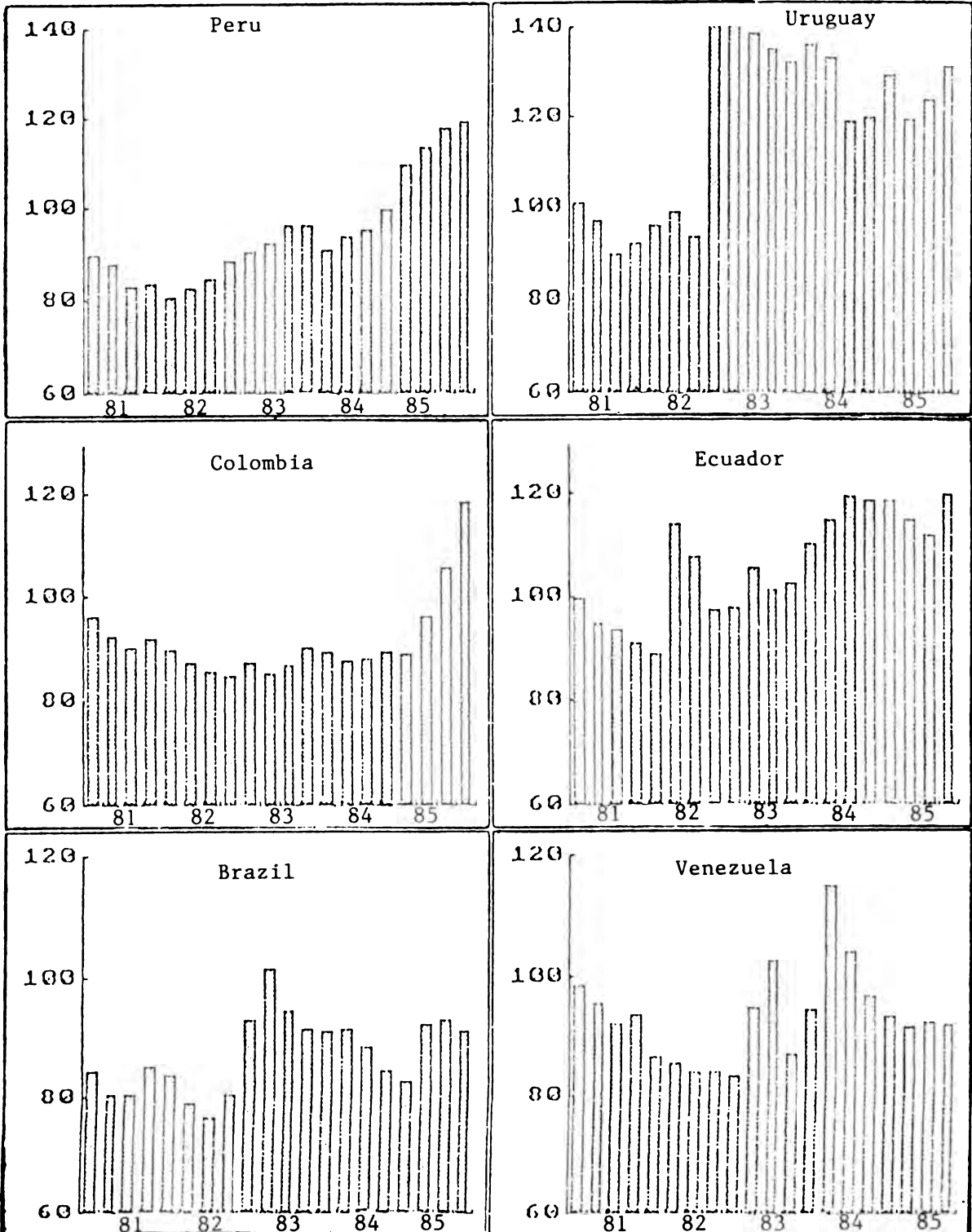


Source: ECLAC

Figure 4 (conclusion)

QUARTERLY REAL EFFECTIVE EXCHANGE RATE INDICES
IN SELECTED LATIN AMERICAN COUNTRIES

(1980=100)



XI. INTERNATIONAL AND REGIONAL COOPERATION MECHANISMS

A. SUMMARY

International commodity agreements

Protection of the what are known as basic agricultural commodities is a tradition of long standing in international trade. Over a period of time, those commodities are also subject to constant fluctuation and a worsening of their terms of trade. This explains why, for example, some 40 initiatives involving 13 commodities have tried to regulate the performance of specific commodities, and why such efforts were institutionalized by UNCTAD in the mid-70s through the Integrated Program for Commodities.

In terms of objectives, international commodity agreements seek to reduce the fluctuations in long-term trends in order to stabilize the income of exporting countries, while influencing the behavior of price levels in such a way as to avoid a constant downturn therein and thus guarantee fair or equitable prices.

Insofar as the instruments are concerned, those agreements call for the establishment of "buffer stocks" or an "agency" that regulates supply and demand. One way or another, this represents application of an effective curb on prices. It has also become customary to set production quotas (as in OPEC, for example), export quotas, or taxes on exports. Naturally, a wide variety of combinations of the modalities cited is possible.

Actual experience has shown that the instruments employed by international commodity agreements are unwieldy and expensive, and that they do not always accomplish the target objectives. In fact, practically none of the countless efforts made in this respect since 1931 has proved successful.

The only system that is actively operating at present is the International Coffee Agreement, which hasn't really succeeded in stabilizing prices. But it has been able to hold prices above the norm --with some assistance from the periodic weather-related crises in Brazil, which help to keep prices high. The Coffee Agreement has been supported in the past by the consumer countries, but such support has waned recently.

Other more ambitious plans to consolidate market interventions have also failed. Such was the fate, for example, of UNCTAD's 1976 proposal to set up a common fund within the framework of the Integrated Program for Commodities. This source of financing was designed to influence the agreements on ten impwere those on coffee andt the only ones reached were those on coffee and rubber. No substantive progress has been made, however, in respect to cocoa, and the United States and Cote d'Ivoire --the largest producer-- have been unable to set up an operating mechanism for this product.

In short, irrespective of the original or intuitive intent of commodity agreements or accords, history tells us that there is really no future for this type of mechanism. As an instrument, it frequently falls far short of trade liberalization (except in the case of coffee, as noted earlier).

The World Bank's policy unquestionably provides strong support for the concept of trade liberalization in the field of agriculture. There has, however, been no categorical pronouncement either for or against food stocks and commodity agreements. In its placements, World Bank policy is to eschew loans for projects that would substantially increase the production of coffee, cocoa, tea, sugar and other commodities because of the external consequences. Certain exceptions have nevertheless been made in the case of projects designed to reorient production.

Multilateral Negotiations

The exposition seeks to address four topics, some of them only in the form of brief references since they have already been presented or discussed in the seminar. The topics in question are: the preferential systems with the greatest global and/or regional coverage (the Generalized System of Preferences, the Lomé Convention, the Caribbean Basin Initiative); and other preferential systems (the GATT Protocol of the 16; and the UNCTAD GSTP).

The preferential systems cited do not provide a mechanism to create permanent flows of trade between developing countries. If the idea is to set up an ongoing exchange of commodities and flows of investments to agricultural projects, the most logical way would be through multilateral and nondiscriminatory negotiations in the framework of GATT; also by stressing the importance of intraregional accords --rather than those between developing countries (South-South trade)-- since substantial benefits to agricultural development may be attained through such integration processes.

The Generalized System of Preferences (GSP) was established in 1971 under the aegis of GATT --thereby violating the "most-favored-nation clause", as a matter of fact. The GSP found its permanent justification in the habilitation clause approved by the Tokyo Round (1979). Tariff preferences are granted under this system. In the case of the United States of America, there are no tariff restrictions.

Another distinctive feature of the system is its emphasis on industrial products, with very little attention to agricultural commodities. This is because it was created to promote industrialization of the developing countries. Its quantitative impact is of little significance, since the goods involved represent only two per cent of the total OECD imports and only seven per cent of developing country exports.

It is difficult to generate a permanent trade flow through the GSP, given the limitations implicit in its eminently temporary and unilateral preferences and safeguard clauses.

The Lomé Convention comprises the agreements between the European Economic Community and the countries of Africa, the Caribbean and the Pacific (ACP countries), replacing the former systems of colonial preferences. These accords are set forth in the Lomé Convention, the third and most recent version of which was signed in 1984. It grants trade and tariff preferences to exports from ACP countries. At present, 66 developing countries are signatories to the Convention, and most of them are among the smallest and poorest nations in the world.

One of the major components of the Lomé Convention is the compensatory financing service known as STABEX. Its purpose is to stabilize the export revenue of the beneficiary countries.

The Lomé Convention is not of great importance because the margins of preference it grants are quite limited. One feature is worthy of mention, however, and that is the diversion effect it has had on trade, which has unquestionably gone far beyond the pursuit of trade creation, thus affecting the interests of other developing countries.

The Caribbean Basin Initiative was established by the United States in 1983 to provide duty-free access of a substantial percentage of Central American and Caribbean exports to the North American market. Some of its features are similar to those of the GSP, but it embodies both tax and economic concessions from the beneficiary countries to the United States. Its impact is aimed at industrial rather than agricultural commodities, since the most important traditional agricultural products are subject to special regulatory systems.

Mention of other preferential systems might include the Protocol of the 16, signed in 1971, which includes developing countries that are signatories to GATT. Three of them are Latin American (Brazil, Chile, and Paraguay). The Protocol is not widely known, for it has not been very effective. Quantitatively, the volume of trade involved represents approximately 600 million dollars, and many of the concessions granted to 16 products are no longer in effect or have ceased to function due to tariff reductions achieved by means of other mechanisms.

The GSTP established in the context of UNCTAD is still in the negotiation stage. Basically, it would comprise all of the countries in the Group of 77. This scheme proposes tariff reductions, but it should be emphasized that the participation of farm commodities would be very limited.

An analysis and review of the preferential systems suggests that the trade developed on the basis of discrimination is not consistent with the multilateral systems that have emerged since the Second World War. The GATT was established for the specific purpose of counteracting their influence.

If we look at all of the preferential systems, the emergence of a series of integrationist schemes authorized by the spirit of Article 24 of the GATT --prominent among which is the scheme developed by the EEC-- the situation of discriminatory trade and bilateral exchanges may be seen to be increasingly

important. It suggests that if we want to promote the type of trade that will permit effective development of the agriculture sector, it will have to be on a nondiscriminatory multilateral basis that allows genuine development of the comparative advantages in agriculture which many developing countries enjoy.

Using the views expressed here thus far as a frame of reference, let us examine the Uruguay Round in the context of GATT negotiations.

In the past, the subject of agriculture was given short shrift in multilateral trade negotiations. In the Tokyo Round, for example, the trade involved in manufacturing concessions topped 100,000 million dollars, while trade concessions in the field of agriculture barely amounted to 15 million. Furthermore, GATT regulations governing agricultural commodities are quite weak as compared to those governing industrial products.

It should be emphasized that the Uruguay Round constitutes the first effort to find relatively permanent solutions to the problems of multilateral trade in agricultural commodities. It stemmed from the ministerial meeting held in 1982 and the work performed by the Committee on Agricultural Trade established in the same year, which formulated fairly concrete proposals.

One of the most immediate antecedents in the area which concerns us was the Montevideo meeting. It stressed the need for greater discipline and foresight in agricultural commodity trade, and to that end recommended that future negotiations should have three purposes: 1) to achieve greater liberalization of trade; 2) to apply more stringent and effective rules and disciplines to subsidies; and 3) to reduce the effect of certain nontariff and sanitation barriers.

Given the considerations highlighted thus far, it should be stressed first of all that the countries' domestic agricultural policies -- particularly those of the developing countries -- are about to undergo a fundamental revision. That represents a totally new situation. Such revision must be aimed at achieving greater liberalization of agricultural markets and strengthening the countries' internal disciplines to make them compatible with the multilateral disciplines that may be developed.

In the second place, emphasis must be placed on the need for the developing countries to seek the necessary countries' agricultural policies. To do so, it seems reasonable that the developing countries should exert pressure through possible concessions in sectors other than agriculture; for example, gradual liberalization of the industrial sector, which has been protected by macroeconomic policies in which Latin American countries might find effective tools for utilization of the agriculture sector's comparative advantages in the services sector.

Finally, we should mention another alternative to encourage heightened agricultural trade growth in the region: the promotion of agreements for regional integration and integration among developing countries (the former offer greater potential). In Latin America, efforts to further regional or

subregional integration schemes can be carried out in conjunction with ALADI. Financing and trade information mechanisms are determinants in making such schemes --particularly the financial ones-- viable, thus affording a means of competing with heavily subsidized imports.

Bilateral and multilateral agreements between developing countries

Searching questions arise to which we must find answers when we try to relate economic integration to the topics we have been examining. To do so, it is essential to assess the present status of the ALADI integration problem issues in the context of multilateral negotiations. At the same time, we must determine the meaning of certain bilateral agreements that have been reached, particularly in the last two years.

It is also expedient to consider the integration horizon or the course that integration should take, especially in the agricultural sector. It might be useful in this connection to recapitulate certain elements of recent experience in the subregional integration schemes of the Southern Cone.

Economic integration is a function of --or rather a somewhat mandatory response, given international protection, to-- the problems confronting traditional exports and the discrimination that occurs in international markets.

Despite existing political and conceptual support, reasonable doubts and qualms persist in regard to the sectoral or intersectoral approach and the problems arising from foreign, or even domestic, protectionist policies.

The goal of expanded trade in agricultural commodities inevitably calls for a review of domestic policies, particularly when complementarity exists in the products that are subject to negotiation. Integration must become an instrument for achieving greater specialization of production, economies of scale for medium and small countries, thus reducing the disequilibria between countries. The basic question is whether integration will lead to the creation of a reasonable economic security zone or conversely, whether it will increase instability. A determining factor in the outcome will be the ability to link trade with the problems of financing and the payment systems that are established.

Any analysis of integration prospects must also take into account a determinant consisting of the varying extent to which intraregional trade is important to domestic economic activities. In assessing the degree of progress, we must not forget the emergence in recent years of new types of agreement in the area of economic complementarity (such as the Southern cone countries; Mexico and the Caribbean Basin countries), which obviously reflect a readiness for policy discussions. This has allowed headway to be made in : regional tariff preferences; and the handling of nontariff measures, among other areas.

The new approaches involved in bilateral complementarity agreements are very promising. In addition to trade within the region, they offer prospects of a gradual rise in extraregional trade with the development of specialized lines as a result of complementary agreements between countries. This new modality is an improvement over the product-by-product type of negotiation, and a step toward overcoming the heterogeneity that exists between countries.

Integration should not be viewed in a polemical framework but as a process that tends to facilitate longer-term productive adjustment, thus permitting new lines of specialization, greater market transparency, and closer linkages between agriculture and the other sectors.

To optimize this new modality of bilateral agreements, the importance of national policies with a highly protectionist bias must not be overlooked. Insofar as the agricultural sector is concerned, it would be interesting if related trade could be incorporated such as, for example, inputs, fertilizers, machinery, and equipment --in summary, negotiation of a broader package that would include agriculture, industry and services.

A distinction must also be drawn between the performances of integration agreements and internal adjustment policies. The handling of problems such as the balance between countries; the possibility offered by integration as a true basis for support to nontraditional exports to the rest of the world; of trade financing mechanisms; the factors that affect relative prices, such as the real exchange rate and the cost of domestic inputs --all of these are very important elements that in one way or another determine the future of this new modality of bilateral agreements.

The redefinition of integration schemes presents an enormous challenge in the conceptualization and quantitative studies used to establish a logical linkages between national policies, integration policies and reasonable levels of protection. Similarly, renewed efforts must be made in the field of technology and basic research --without limiting them to the agricultural sector, of course. All of these factors obviously call for a new delineation of the role played by the state in the spheres of rural development, technology, investment, and financing.

This entire exercise in the area of regional negotiation is a very useful basis for working out multilateral negotiation schemes in Latin America. It will undoubtedly prove highly rewarding in negotiations under the GATT, and those involving external debt, since it also implies a palpable heightening of bargaining power.

Regional and Subregional Integration in Latin America/

The presentation of this topic began with the proposition that --contrary to the belief in certain circles that integration and Latin American cooperation are a thing of the past-- the regional and subregional approach is now acquiring renewed currency. It is seen today as a line of structural adjustment that, in addition to the potential for intrinsic benefits it embodies, may facilitate the task of regaining Latin America's foothold in the international economy. In more general terms, regional and subregional cooperation and integration were confirmed as one of the few endeavors that Latin American countries can undertake to help themselves out of the crisis.

In the next stage, regional cooperation and integration are part of a global outward reorientation of the economy, and not --as in the preceding stages-- an attempt to confine the economy to the nation's domestic production efforts, as in the case of import substitution. Significant achievements would be possible with such reorientation. The first is a short-term increase in trade inside Latin America, with a consequent improvement in the position of these countries in nonregional markets, thanks to the lower costs resulting from enhanced utilization of the installed capacity. The second is development and strengthening, in the medium term, of a network of productive relationships that are better able to penetrate broader and more competitive economic arenas.

It was recalled, based on available experience, that in the early stages, integration and regional and subregional cooperation were confined to the manufacturing field. They did not extend to agriculture because of the lack of complementary based on different endowments of natural resources which can lead to specialization. Nor was it necessary to increase the size of the market to be developed: for agriculture economies of scale did not present a problem, even though they were present in the industrial sector. For most agricultural products, few trade was not necessary and neither was a common trade barrier needed to protect agriculture since import substitution of agriculture was not an issue.

Under the given circumstances and in the absence of a productive agricultural apparatus of regional and subregional dimension, integration on the demand side led to dislocation phenomena and market distortions which had to be corrected immediately, as it was in fact a question of supplementary internal production with imports. The result was that agricultural integration was reduced to sporadic exchanges of deficits for surpluses within a regime of quantitative controls of imports and exports.

1/ Synthesis of Dr. Carlos M. Castillo's presentation

In the subregional ambit, the regime of exchanges in use will have to continue in the short and medium terms, at least as long as the reasons indicated gave birth to it continue to exist. However, and during this same lapse of time, integration and cooperation should be directed towards demands, there was a concensus for action to concentrate on the following: 1) relocation of production towards more appropriate zones, from a subregional view point, taking into account the actual and foreseeable development of physical infrastructures; 2) border integration for not only economic reasons but also for cultural and political ones; 3) coordinated and joint investments in agricultural research, updating of markets and agroindustrial instalations; 4) horizontal cooperation in the transfer of technology; 5) development and integration of the cooperative movement; and 6) settlement, education and employment of refugies and displaced the marginized peoples.

In the next step, it would be proper to extend agricultural integration and cooperation to the ambit of relations between countries of different subregions and different levels of relative development, three modes of action were identified: 1) production of basic foods in same countries with surpluses that could cover the needs of chronic shortfalls of other countries, for example the main petrol producers such as Mexico and Venezuela, touristic centers like the Carribbean ; and apply to the food security concept a regional instead of a national dimension; 2) supply of basic goods from the temperate zone of Latin America (for example, wheat) to tropical zone countries; and 3) manufacturing in Central American and the Caribbean of raw agricultural products from Latin American countries of higher development to produce food crops to be sold to, for example, the United States of America, within the scope of the Caribbean Basin Initiative. It was further said that measures 1 and 2 required the elimination of the subsidies instituted by the developed nations to their agricultural exports.

Discussion and pending matters

The data point to extensive trade possibilities to increase the domestic food self-sufficiency ratio in the region. It would be interesting to determine how much additional trade would be "created" through regional mechanisms, and how much would simply represent a "diversion" of present flows.

Modernization of farm production and intraregional agricultural trade would result in a redistribution of income to the exporter countries. There would also be an "unfavorable redistribution of income to certain producer groups" in various countries. The distribution among countries is particularly important for the ones that import cereals, which today enjoy the benefits of OECD protectionism. The possibility of compensating such countries, as an inducement for them to enter into a regionally integrated agricultural trade system, could be examined.

Sharp imbalances of all types exist among the countries of the region, some of which --ranging from macroeconomic policies to the type of producers and their relative degree of modernization. It should therefore be emphasized that the benefits of liberalized agricultural trade or integration systems will not

accrue equally to all of the countries involved. Consideration should be given to whether liberalization of agricultural trade or any form of integration would induce or "foster agricultural modernization and rural development in the medium term". Every integration scheme considered should assign particular importance to the "financing" of trade and "market information".

Integration can provide some protection against external conditions, securing for the region its own markets and thus freeing foreign exchange. It can also provide a basis for additional bargaining power in trade negotiations with industrialized countries.

The present low level of agricultural imports should not be interpreted to mean that little remains to be substituted, thus offering little scope for negotiating in integration. Increased imports are essential for growth and offer possibilities for intraregional agreements, replacing nonregional imports.

The failure of commodity agreements should not be exaggerated. It is true that the industrialized countries lacked the political will to make these agreements really effective. But the same lack of will existed in regard to the success of multilateral free trade. Frustration over commodity agreements need not necessarily result in a blind belief in free trade.

Integration will not progress unless there is conviction and political willingness to bear the costs in order to reap future benefits.

In addition to agricultural trade integration, there is ample scope for an increase in intraregional technical cooperation in agriculture.

The countries should give their representatives at multilateral financing organizations a mandate to have such agencies coordinate financing for integration.

XII. MANAGING THE INSTRUMENTS OF AGRICULTURAL ADJUSTMENT

A. SUMMARY

Introduction 1/

During its forty years of existence, the World Bank has conducted an ongoing and active program of support to the agricultural sector. Traditionally, this has consisted of the financing of investment projects: irrigation, agricultural credit, rural development and --more recently-- support to research and extension services. In the early 80s, the Bank began to realize that this traditional line of endeavor would no longer suffice, and it began to finance its member countries' balance of payments by means of structural adjustment projects and loans.

The structural adjustment loans produced a quick infusion of foreign exchange, affording the necessary financial support to surmount the balance-of-payments crises. At the same time, however, these loans are designed to support policy reforms in the recipient countries. The first structural adjustment project was carried out in Peru in 1979, and financing of the first sectoral adjustment loans to the agricultural sector started in 1983.

Thus far, five structural adjustment loans have been disbursed (Argentina, Brazil, Colombia, Ecuador, and Uruguay). Others in this category have featured a macro-economic approach, but involved important changes in farm policy, e.g., Costa Rica and Panama.

The issues addressed by the World Bank in its discussions of sectoral operations with member countries include the following: price policies (at the producer and consumer levels), as well as prices more broadly defined from such standpoints as the exchange rate, interest rates and trade regimes; the quality and quantity of public investment; the efficiency of public services available to the agricultural sector (ministries and parastatal agencies); a cutback in subsidies that are financially untenable and that in many cases are designed to support low-income producers or consumers, an objective which is not always attained, and curtailment of the regulations that keep the agricultural sector from functioning efficiently.

In summary, the aim is to redefine the respective roles which the public and the private sectors should play in agriculture. Contrary to the opinion voiced by critics, this question is not addressed with ideological rigidity: instead, the aim is to try to help the agricultural sector to function more effectively. The emphasis is on efficiency, not on mass privatization of all operations in the agricultural sector.

1/ Summary of the introduction by Mr. Francisco Aguirre Sacasa, Assistant Director, Latin America Projects Department, The World Bank, to the presentation by Mr. L. Reca.

Presentation

For agriculture to be stimulated the deep pessimism that today pervades the region in regard to this sector must first be overcome. This attitude is founded on low international prices for primary products face by contrasting high rates of interest.

International conditions alone limit the use of traditional policy instruments. For example, the decline in international prices has been so drastic that it cannot be offset by eliminating the amounts withheld on exports. On the other hand, the macroeconomic policies that lead to stabilization now enjoy the political support they did not have some years ago (prior to the spiraling inflation experienced by some of the countries); unfortunately they also contribute to the sector's discouragement. In fact, the quest for macroeconomic equilibrium produces policies that in effect --at least in the short term-- discourages efforts in this sector.

Adjustment and stabilization of the economy on a whole call for a redefinition of the terms of reference for sectoral policy. More specifically, macro decisions result in a forced contraction of the productive base (activity and investment levels fall) and reduce the array of instruments that could promote growth and incentive policies for the sector.

For example, macroeconomic adjustment limits the means of growth in various ways, such as:

- With respect to taxes, heavier assessments are levied;
- the exchange rate needed to stimulate exports must not be too high or fiscal deficit and service problems would increase;
- internal credit is restricted;
- the limited funds available for lending boosts the interest rate to producers;
- public sector salaries are set rigidly at the lower end of the scale, and public spending on development services must be cut back.

The entire process requires arduous policy negotiation with producers as well as within the government itself.

There remains the possibility of applying new indirect instruments, such as the exchange of fertilizers for wheat. Maximum efforts must also be directed toward structural change in such areas as marketing, agro-industry and tax policy. "Policy loans" from multilateral financing agencies might prove very useful in this respect.

Comments

References made to national experiences in certain countries were useful to illustrate adjustment policies.

In Argentina a limited number of sectoral instruments is observed and some innovations have been introduced, such as the supply of inputs in kind, with payment taking the form of the product itself in order to avoid diversion of credit to speculative activities. When fertilizers are exchanged for the product, the credit is genuine and represents part of an international trade operation tantamount to the one performed by the government with the producers.

Costa Rica has drastically reduced the National Production Council deficits, which were financed by the Central Bank. To accomplish this, the support prices for rice and sorghum were eliminated, although it is not clear whether these measures have benefited the sector or not. It is clear, however, that a sectoral adjustment must be made for internal sectoral reasons by creating an exporting base; but the producer must be assured a profit, and the state must be willing to cover the cost of the adjustment devised to create the new structures.

In Ecuador, exports of a nontraditional commodity (shrimp) doubled and imports of inputs and machinery rose between 1984 and 1986. The sectoral adjustment was positive, as is evident from the rice and corn surpluses generated in 1986. But the new decline in oil prices and the recent earthquake have thrown the productive structure off balance again, requiring consideration of the need to strengthen monetary and food reserves.

In Mexico, the attempt to apply sectoral instruments to a new macroeconomic context has necessitated the drawing of a sharp distinction between types of products and types of producers.

In Peru, a tax on wheat imports enabled the marketing agency to generate revenue to cover fertilizer subsidies and offer guarantee prices for other commodities. The increased consumer price of wheat helped to divert consumption to potatoes, and the higher price of potatoes was an incentive for production, particularly in the Sierra. The use of a lower exchange rate for wheat imports also afforded gains for the marketing agency.

In Venezuela as well, incentives were used to stimulate production, resulting in a cutback in imports. The danger of misdirection of resources in the long term is nevertheless recognized.

Discussion

A number of noteworthy points were brought up during the discussion, such as:

The revision of the bias against exports may make the economies even more vulnerable, and not just because of the greater dependence of world markets

on the end product. For example, an agriculture that is more dependent on agrochemicals might be particularly sensitive to possible future macro adjustment.

It is difficult to define the role of sectoral policy when the macro adjustments are sudden and frequent. The focus on the way in which traditional incentive instruments are limited must therefore be widened to encompass the extent of such limitations as well. In countries that derive absolute agricultural advantages from the land, the value which producers assign to this factor incorporates induces new stringent policy measures. As observe, in Argentina for example, the direct production costs will allow for profits, in spite of rather ungenerous incentives. But the rate of return to producers becomes far less attractive when land values are taken into account.

Compulsory product substitution and access to subsidized imports may give rise to serious agricultural development problems in the medium and long terms.

A consensus was apparent in respect to the following points:

- Attention must be given to rural development as a means of promoting modernization and enhancing the quality of life for producers.
- Macroeconomic and sectoral equilibria are not absolutely incompatible. Different measures, different time frames, and different interests may be reconciled. But there is a period of incompatibility which each country must negotiate within its policy context.
- Sectoral adjustment calls for complex policy mixes that must satisfy the following criteria:
 - . response to the internal conditions of each country;
 - . attention to domestic consumption, not to exports alone;
 - . the action taken must exercise care in regard to the different time frames. Thus, in the long term, the aim is to adjust domestic consumption and production to new world conditions. Short-term adjustment, motivated by external deficits, must not be allowed to impede the accomplishment of long-term objectives;
 - . the roles of the state and of various private groups must be redefined;
 - . a balance must be struck between long-term supply and demand, seeking a diversification of products and markets, heightening the ability to compete internationally, and

focusing particular care on the modernization of post-harvest processing methods and on marketing beyond the country's borders.

- . the present crisis may have the beneficial effect of a compulsory focus on objectives.

The existence of discrepancies was suggested in regard to the possible shortage of policy instruments to make incentives effective and of sectoral policy instruments that could be applied in the context of macroeconomic adjustment. This would in any case constitute an area requiring very careful thought.

A wide range of positions and experiences was described in regard to macro adjustment and its effects on the level of sectoral activity in the short term.

Certain areas remain pending that call for special consideration. They are the following:

- Do stabilization and macroeconomic adjustment inevitably trigger a shrinkage of the sector's productive base, as indicated by a number of experiences? Or, conversely, does this depend on the individual circumstances of each country and the pace and quality of the sector's incentive and development measures?
- Can there be real subordination of the short term to objectives of innovative change or, on the other hand, does macroeconomic pressure impose action that impedes modernization? To what extent can sectoral and structural loans help reconcile the two? Can integration contribute to this reconciliation of objectives with different time frames?

B. DISCUSSION DOCUMENT

Dynamization of Agriculture in the Context of the Actual Economic Situation 1/

In the face of the imperious need to make agriculture's role in Latin American and Caribbean countries more dynamic, a generalized discouragement is unfortunately seen to prevail regarding the production potential of agriculture in our countries. Obviously, this circumstance could reinforce the formulation of policies that impede the sector's development, which in a circular process of cause and effect would perpetuate generalized pessimism as to the future prospects of agriculture. It is true that in a region as heterogeneous as Latin America, this statement cannot be applied uniformly to all of the countries. The predominant feeling, however, is the one described.

The climate of uncertainty is heightened by low international prices and high interest rates. The latter channel funds to the financial market instead of to the productive activity. This helps to explain the decline in investment in the agricultural sector, which ends up by jeopardizing the sector's future growth.

The problem issues that concern us today could be posited in the following terms: How can we make the role of agriculture under present conditions more dynamic in concrete terms? Those conditions are characterized by: 1) an adverse situation in international markets, with world prices reaching the lowest levels posted in the last 40 or 50 years; 2) a high cost of credit; and 3) an internal situation in which most of the countries are immersed in adjustment and stabilization plans that severely limit the possibilities of effective and efficient implementation of specific policies within the sector.

The stabilization or adjustment plans have emphasized the interdependence of agriculture with the rest of the economy. This is nothing new from the academic standpoint, since agricultural economy cannot be viewed as an enclave or a topic for academic discussion nowadays. On the contrary, it comprises a living force, because what is at stake is nothing less than the possibility of formulating an agricultural policy in the face of the constraints stemming from the performance of the rest of the economy.

This is a vital issue. The agricultural economy must redefine its terms of reference, for otherwise we shall find ourselves manipulating a series of instruments red in terms of their ant when measured in terms of their influence on the sector.

1/ This document is an edited transcription of the presentation made by Engineer Lucio R. Reza. Its content does not necessarily reflect the opinions nor official policies of the World Bank or of the Interamerican Institute for Cooperation on Agriculture.

The adjustment and stabilization plans frequently applied in the area are based on the hypothetical conviction that there cannot be sustained economic growth without stability. In examining or evaluating agricultural adjustment policies, we must not lose sight of the nature of the adjustment programs that frequently comprise the backdrop of the overall economic policy for the area. Today it is evident that stability has greater social priority than in the past, in many countries resulting from their experiences with hyperinflation that posed a threat to social equilibrium.

For Latin America, the cost of these stabilization and adjustment programs has been very high. In economic terms, there was a net transfer of resources abroad of about 130 billion dollars between 1981 and 1986. This tremendous outflow of foreign currency significantly curtails the room for sectoral policies. Under such circumstances, public investment in agriculture declines, the cost of credit rises in inverse proportion to the availability of lendable funds, any subsidies that existed dwindle, and fiscal pressure tends to build up.

In Argentina, where an export tax on agricultural and livestock products has been continuously in effect for the last 40-45 years, the plummeting of basic commodity prices elicited great pressure from representatives of the sector to have those taxes cut. Even so, the reductions obtained by no means offset the drop in prices. This shows the inability of rigid tax collection systems to adjustment, especially in times of crisis. Under such circumstances the agricultural sector remains at a disadvantage for lack of a compensatory adjustment of tax cuts.

As a result, we can stage without exaggeration that there is a contraction of the productive base. Contraction that clearly shows the inconsistency between short-term stabilization objectives and the long-term goal, which is growth. As a result, there is no bridge or logical link between the two objectives. On the one hand, there is the stabilization policy, defined by a series of manipulations of economic variables. On the other, there is the growth objective, and no policy measures are applied that would achieve it in the agricultural sector. In general, we might conclude at the start that by giving priority to the adjustment program, the set of concomitant macroeconomic policies has a dampening effect on the agricultural sector. For instance, the commitment to pay interest on the external debt tends to accentuate fiscal imbalance, thus requiring a tax increase. Consequently, no easing of fiscal pressure can be expected as a result of the adjustment plan.

Let us see what happens with the exchange policy. While a high real rate of exchange to promote exports is admittedly desirable, it also has an impact on the fiscal deficit, since the debt service payments call for higher disbursement levels, making the deficit even greater. Furthermore, we must not overlook the socio-political resistance triggered by the effect of a high real rate of exchange on the cost-of-living index, directly or indirectly boosting the cost of food.

Another conventional tool of economic policy, credit, is also adversely affected. The external imbalance limits the degree of freedom to apply for external credit, enhancing its scarcity. Domestic credit also becomes more expensive, thus affecting production. Moreover, the limited funds available for lending purposes are channeled to speculative investments. In short, credit costs the productive sector far more than it did prior to the adjustment process.

As to price policies, when the adjustment programs have been carried out parallel to the setting of ceiling prices, the result has been a contraction of exportable surpluses, owing to the combined effect of a production downturn --because of the disincentive of price ceilings-- and heightened domestic consumption thanks to the price subsidies.

Insofar as the wage policy is concerned, we must remember that the public sector wage policy, which is a relatively important constant in Latin America, has shown a clear tendency to remain at rigidly low levels, so that this factor also has a certain amount of influence on the fiscal deficit.

Under these circumstances, if we accept the social priority of stabilization and adjustment programs, how can we reconcile it with a policy of agricultural growth? Given the parameters contained in the present brief analysis of tax, credit, price and wage policies, it is obvious that considerably less elbow room remains for maneuvers involving the conventional instruments of economic policy.

Assuming that we accept the validity of those premises, how can the agricultural sector be developed to perform its role in such a way that it can meet domestic demand for food supply and generate exportable amounts? All the while keeping in mind that the present macroeconomic order is dominated by policies from which little help can be expected in promoting agricultural production.

Although the situation described is fraught with constraints, a series of instruments --indirect ones-- nevertheless remains that can unquestionably have an influence, albeit not so immediate nor determinant as the classic components of economic policy. We shall address them briefly.

Prominent among the indirect instruments is technological policy. We must point out in this respect that the technological process is one that has become markedly transnationalized in the last few years. We can therefore assume that technological knowledge is available as a result of external transfers. If it exists, its adoption will depend on profitability. But if that is depressed by falling prices and the other factors cited, it can be offset in part by adequate extension work.

It should be stressed that all technology is not the same. We are talking here about management technology, which as such does not entail major cash out-lays or credit financing, and hence has a better chance of being

adopted --and thus of boosting productivity-- than would be the case with capital-intensive technology.

The policy of providing modern inputs to heighten productivity in agriculture is hamstrung because the higher cost of credit impedes access to those inputs as a result of the higher cost of credit. That makes it a risk factor for an entrepreneur which is even more acute because of the restrictions inherent in the financing mechanisms for this type of operation. One way to solve those problems is by means of the so-called barter system, whereby a previously determined amount of the product, decided on at the start of the operation, is paid at the end of the harvest. This makes it possible to solve at least part of the problem of lack of demand, triggered by the high cost of credit.

In Argentina, such programs have been used in the last three years to finance fertilizers for the wheat crop. The problem of production is thus solved without inflationary effects, which means that two conditions are fulfilled at the same time: 1) keeping within the adjustment program; and 2) adopting measures that foster expanded production.

Another policy that can help to sponsor the development of the agricultural sector is the marketing policy. The fall of world prices revealed some of the marketing flaws such as excessive profit margins, unnecessary intermediation, and the like. The presence of these factors results in lower prices to the producer, thus cutting the rate of return, thereby leaving less money to invest --all of which inhibit the growth rate.

An exhaustive study on this subject is being conducted in Argentina. It examines the marketing conditions, both domestic and external, for meat and grains, and seeks to identify the greatest shortcomings, proposing corrective measures to make the economic system more efficient. In this case, marketing reform implies an effort of a structural nature, meaning two things: 1) that its effect is not going to be felt immediately; and 2) that there will be sectors that will loudly and forcefully oppose any change in this field.

Another area of agricultural adjustment that can contribute to the sector's growth is the entire field of agro-industrial policy. In this case, processing of the primary product can be conceived as the activity that transforms the biomass generated in the sector. Signals in the international markets reflect the resulting changes. State of the art technology, the opportunities that are opening up with new developments in engineering and biotechnology acquire a very concrete significance when it comes to building up a modern agro-industrial complex to enhance the primary sector's chances for development.

Biotechnology is changing the production processes in a great number of food sectors, as well as in the processing sectors for agricultural products. Articulation of a proposal centered on agro-industry can express the will to progress toward modernization of the economy, with the tremendous advantage of basing that industrialization strategy on a supply sector such as agriculture,

which guarantees internationally competitive prices of raw materials. Bolstering the foregoing arguments, an approach of this nature has the political importance of offering --at a time marked by pessimism concerning the outlook for agriculture-- modern agro-industry as a new and promising alternative, a new field that opens up with a renovating flourish.

The field of tax policy can also be included in what we may term structural change or reform. Such policy can take many forms, but in the last instance its response will depend on the type of sector to be developed. The urgency of fiscal needs usually results in a tax structure laden with disincentives and often featuring greater fiscal pressure than in other sectors, thus leading to an inadequate distribution of resources.

The conclusion to be drawn from this brief assessment of the different indirect forms of action in the agricultural sector, as a response to adjustment programs and as a means of generating growth, is that the economic adjustment program will be successful in the sector if structural reforms can be implemented to offset the fall of international prices and the simultaneous hike in the price of credit. It must nevertheless be remembered that the downturn in income has already occurred, whereas the prospective structural improvements require a certain amount of time.

We are therefore faced with a sequence problem: on the one hand, phenomena that have already occurred; on the other, anticipated changes that will require time to be implemented. How can we bridge the gap between the two? How can we graft one phenomenon onto the other? Later on, we shall deal with this dichotomy.

We are thus faced with a conflict between the short and the long term. The latter is understood to mean the time frame in which the sector will be able to grow and develop, and the short term to mean a period in which the instruments of conventional economic policy are so rigidly fixed that they cannot render useful service from the standpoint of sectoral promotion and development. If this conflict and incompatibility are not solved, the level of sectoral activity will contract, and that will affect the stabilization program by means of inflationary pressures resulting from the downturn in production. That would in turn aggravate the problem of generating foreign exchange in the case of tradable goods, whose production will also decline. In short, both tradable and nontradable goods would be affected and this will of course have an undesired and harmful effect on the stabilization programs.

We must be aware that structural reforms represent a readjustment and redefinition of income distribution and of the political power of participants in the social process. The speed at which society can move as a result of these changes takes on critical importance, and this is an open question that will not settle for a general answer. The specific answer will depend, in the last analysis, on society's will to accept and shoulder a reform program. It is nonetheless essential to raise the question.

A few years ago, the multilateral financing system --especially the World Bank-- started a new operational financing modality that in my opinion could lay a bridge between the short and the long term, in other words, between short-term adjustment policies and the agricultural growth objective entailing structural reforms that must be implemented to resolve this impasse. These new forms of financing differ from the customary funding of investment projects in the traditional production fields as well as in social areas. We refer, as is obvious, to the sectoral adjustment loans. This type of lending seeks to satisfy two objectives: 1) on the one hand, quick disbursements; and 2) on the other, promotion of reforms in the economic policy. The latter is the conditionality of the credit that is discussed and agreed upon between the beneficiary country and the Bank. This method accounted for about 20% of the volume of credit granted by the World Bank in 1986 --a very high percentage, and one that is still rising.

Thus defined, these credit instruments seem to provide appropriate ways to accelerate, or perhaps to reinforce, the process of structural reform in agriculture in such a manner that it can adapt satisfactorily to the restrictions imposed by the global adjustment program. This, of course, is only one of the possible avenues, and it must not be interpreted as a panacea or a prescription to cure all ills. When one asks what chances there are of finding a mechanisms that can harmonize the short-term requirements of stabilization programs with the essential and undeferrable requirement of agricultural growth, this credit modality would appear to be useful in providing the answer.

In order to be effective, however, these credits require a goodly input of political economics. The dialogue between the beneficiary country and the Bank must be based on a clear perception of reality and an objective evaluation of the possible success of policy changes. Thus it is not a matter of preparing a long list of utopian aims, but of correctly indentifying the key elements and determining whether those elements can be modified and adapted in each country. In this scenario, common sense and objective analyses of reality replace quantification of rates or return and assessment of other factors that are impossible to estimate in these cases.

On the other hand, the deeper the knowledge of reality, the sharper and simpler the political conditionality of the sectoral loan can be. One can also conceive of a combination of political conditionality when establishing certain reforms and creating conditions for the insertion of specific investment projects, formulated and designed in that political context. This would make it possible to combine quick disbursement of the sectoral loan with the execution of investment projects that would improve the sector's production or productivity, at the same time ensuring the link between the political conditionality and the rationality of the investment projects. It should be noted that the sectoral loans have no direct impact on the sector, since the disbursements tend to strengthen the balance of payments. What we have here is the possibility of finding a way to direct political conditionality to investment projects that could increase the productive base.

As is evident, we are still looking for a means of logical coordination of short and long-term factors. And in this plan an important role can be played by international technical cooperation agencies such as IICA in setting up programs, analyzing conditionalities and identifying projects.

What has been said thus far may be termed "indebtedness for purposes of efficient growth", and, more than in name, it implies an attitude of mature responsibility, shared by debtors and creditors.

If we compare the situation existing in 1987 with the scenario of three or four years ago, some elements might be discerned that would support the idea that the distance between creditors and debtors is being abridged, and that both are affected by the debt. Also that it is necessary to try to handle this situation in such a way that it would be acceptable to all without incurring intolerable social costs.

In short, we might say that a good part of the way has been covered, but more progress must be made until we can improve this type of model or approximation, which unquestionably offers promise.

By way of a summary, although by no means an exhaustive one, we might highlight the following factors:

1. The adjustment programs adopted by many of the countries in the region in response to the need to put their economies in order pose a conflict between the short-term stabilization objectives and the medium-term growth goals. This conflict is dramatically clear in the case of agriculture.

2. Both export-led agriculture and the inward-oriented type suffer the results of the adjustment programs.

3. The generalized nature of these programs show the extent to which agricultural policy has ceased to be a self-contained concept, and how macroeconomic policies such as the budget deficit, capital movements, the real exchange rate, and other factors come to exert a decisive influence on development of the sector. The conclusion in this case is simple and obvious: either the scope of agricultural policy is expanded, or it will cease to be an appropriate instrument for guiding public decision-making in this sector. Once again, we emphasize that this undeniably calls for a reassignment of political power within the state, which is no small consideration. And this applies equally to the trade institutions that represent the sector.

4. These claims as to the nature and scope of agricultural policy in today's world --which in my opinion are essential to allow full expression of agriculture's productive forces, with the consequent social benefit --in many places face a marked skepticism stemming from the low international prices that cast a shadow of doubt over the social advantage of throwing more resources at the agricultural sector. It is imperative to clarify this area. The expediency of promoting production under any and all circumstances must be posited and proven, adverse market conditions notwithstanding.

Finally, and in the face of the difficulties which the global adjustment programs impose on the agricultural sector, structural reforms will provide a means of restoring profitability and, in the last analysis, capability for growth, which will in turn guarantee the success of the adjustment programs. We are speaking now of two factors that are closely interrelated. It is not a matter of adjustment programs on the one hand and leaving the fate of the agricultural sector to its own devices on the other. The two are intimately linked, and unfortunately the importance of this linkage is not perceived as clearly or as adequately as one would like.

The capacity for growth in the agricultural sector --which in turn will ensure the success of the adjustment programs-- depends on the implementation of structural reforms. Those reforms, as we pointed out earlier, can be supported by multilateral financing: a relatively new area, and one that lends itself to a fertile and mature dialogue in the framework of an adjustment that we hope will be accompanied by growth.

PART FOUR: ANNEX

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Autor

Memoria. Seminar on trade and
pricing policies in Latin
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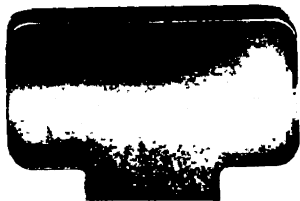
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Nombre del solicitante

0 5 MAY 1994

Heriberto





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