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THE RELATIONSHIP BETWEEN TRADE AND DEBT

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SUMMARY

1. The existence of a relationship between trade and debt is a contentious issue. In fact, a clear divide exists between developed and developing countries regarding the subject, a division which has necessitated the formation of the

Working Group on Trade, Debt, and Finance (WGTDF) within the World Trade Organization (WTO).

2. This paper is of the opinion that such a relationship does exist and that it has been and continues to be of a particularly negative nature. The problem of large debt overhangs in developing countries is unequivocally a result of the particular circumstances of their terms of trade within the international economic system. For this reason, the objective of this paper is to examine the impact of world trade conditions on the increasing debt burden, and the effect of external indebtedness on the trade performance of developing countries with a view to providing remedial measures and flexibilities within WTO provisions.

3. There are a number of factors which have intensified this problem for developing countries, and the ways in which these factors behave in or are acted upon by the global trading system simply accentuates the debt crisis. A main factor is the continued reliance of developing countries on primary commodities and/or low value-added goods. The past and present performance of these products on the world markets have been unpredictable and, in fact, quite volatile. Unable to rely on assured incomes, the shift to higher value-added goods production is nearly impossible for developing countries.

4. The second factor is the continued application of poorly-planned policy reform advice, especially that tied to new loans and debt relief.

5. General terms of trade issues make up the third, and perhaps most encompassing, factor. These concern international trade and financial institutions-sanctioned protectionism and discrimination against developing goods and the limited amount of investment being offered to developing countries to assist them in breaking free of the debt trap.

6. The global trading system as a whole and the international trade (World Trade Organization) and financial (International Monetary Fund and World Bank) institutions play major roles in the continuation of this trade-debt problem. There are trade (primary commodity price instability, balance of payments, tariff and non-tariff barriers) and financial (financing and exchange rate fluctuations) attributes of the global trading system which need to be addressed.

7. The international trade rules designed and enforced by the World Trade Organization reflect major inequalities between members and within the larger world trading system. Lopsided ‘free’ trade constitutes the main problem that continues to be inadequately approached.

8. Conditionalities continue to be attached to loans and debt relief mechanisms which are poorly designed and mismanaged by the International Monetary Fund and the World Bank. From Structural Adjustment Programs to the

Heavily Indebted Poor Countries Initiative, supposed relief programs have more often than not served to increase the debt burdens of developing countries. Furthermore, the accompanying policy advice tends to have as its aim the repayment of the debt, rather than addressing the root of the problem, namely the low level of development of the debtor countries.

9. This paper offers recommendations for further action, suggestions for consideration by the WGTDF in preparation for the 5th Ministerial Conference in 2003. These include a need to improve the market access for developing countries' goods to a point where 'access' is no longer an empty term, but one which implies 'entry' as well.

10. The domestic capacities of the developing countries also need improvement. As the old adage goes, give a man a fish, he will eat for a day; but teach a man to fish, and he will eat for a lifetime. Several options for achieving this goal are mentioned, from greater support through more efficient technical assistance initiatives to increased 'South-South' coordination and information sharing with NGOs.

11. Finally, current debt relief mechanisms need to be revamped to take into account the individual needs of each developing country. Furthermore, alternative measures should be implemented, with debt swaps and forgiveness increasingly replacing debt refinancing and rescheduling.

12. Other important but perhaps more long-term strategies for alleviating the negative effects of the relationship between trade and debt include:

- organizational reform (with the aim of making ownership of existing and future policies universal),

- a return to the intended role for UNCTAD (providing analysis of the development needs of developing countries – advice which would be taken into serious consideration when negotiating future agreements in international trade and financial institutions),

- efforts to stabilise the markets of concern to developing countries (primary commodities & low value-added manufactures) to better assure them more reliable incomes,

- more Special & Differential Treatment options to apply to existing agreements which play a role in the trade-debt relationship, and

- a concerted effort to increase investment and unconditional aid to developing countries to the 0.7% of the combined GDP of all developed countries decided upon in the 1970s.

THE RELATIONSHIP BETWEEN TRADE AND DEBT

I. INTRODUCTION

1. Within the framework of the global trading and financial systems there is much debate over the composition of the relationship between trade and debt. Many developed countries have been disinclined to discuss this linkage, let alone acknowledge its existence.

2. For developing and least-developed countries (LDCs), the perception of an important link between trade & finance and trade & debt is commonly held, however other issues (i.e.: implementation and fulfilment of requirements) remaining from previous World Trade Organization (WTO) decisions and agreements, remain their immediate concern. For these reasons (lack of interest on the part of the developed and limited capacity on the part of the developing to introduce this subject), the issue has not received much attention in most international fora.

3. As developed countries are rarely, if ever, faced by the complex interplay of issues with regard to trade's effect on debt and finance, this area is unlikely to be broached in future discussions unless developing countries force it to the front. It is believed that the Working Group on Trade, Debt, and Finance (WGTDF) will be the vehicle for this struggle, with the eventual aim of incorporating it into the discussions and negotiations leading up to and at the 5th Ministerial Conference next year.

4. The WGTDF is not a negotiating group; its mandate clearly defines it as an examination and advisory committee.[1] Moreover, since developed countries do not seem to see the process in the working groups as an exercise that would lead to specific recommendations and decisions, it is crucial that developing countries take the initiative to push the discussions further. The importance of these issues must be made clear before the group to ensure their incorporation as subjects of negotiation in future WTO agendas. The work-to-date of the WGTDF will be due in Cancun next fall; a clear outline of work to do must be ready for that time. Discussion, and hopefully agreement, on these issues, should be at an advanced enough point to launch negotiations on these issues at the conference in 2003.

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[1] *"We agree to an examination, in a Working Group, under the auspices of the General Council, of the relationship between trade, debt and finance, and of any possible recommendations on steps that might be taken within the mandate and competence of the WTO to enhance the capacity of the multilateral trading system to contribute to a durable solution to the problem of external indebtedness of developing and least-developed countries, and to strengthen the coherence of international trade and financial policies, with a view to safeguarding the multilateral trading system from the effects of financial and monetary instability. The General Council shall report to the Fifth Session of the Ministerial Conference on progress in the examination."* ('Doha Ministerial Declaration,' Paragraph 36, 2001)

5. This paper seeks to aid developing (and developed) countries in addressing the key concerns of the relationship between trade and debt, in anticipation of the third meeting of the WGTDF to be held on 30 September, 2002. In order to understand this link, a look at the history of debt is necessary. Therefore, this paper opens with an examination of the debt crisis as begun in the 1970s. The evolution of the problem is reviewed, noting the main factors in the continuation and worsening of the debt burden for developing countries, including a look at the current global trade system as governed by the international trade and finance institutions: the WTO, the International Monetary Fund (IMF), and the World Bank (WB). Finally, in light of all of this, recommendations for further consideration are made, proposals geared towards advancing the understanding of the relationship between trade and debt and its effect on development and international trade in the hope of placing the issue in future WTO negotiations' agendas.

II. BACKGROUND

6. Despite the denial or ignorance of a link between trade and debt, many can not deny the perpetuation of an actual debt 'crisis' dating back decades. Before embarking directly on the linkage between trade and debt, it is necessary to look at the evolution of the debt problem. While this in itself is linked to trading trends of the time, specific world-wide economic events were the main contributing factors.

7. The first major precipitating event was the action of the United States' government to print more dollars, lowering the value of the world's stocks of dollars. In addition, the U.S. took the dollar off of the gold standard, disrupting the economic systems of other countries (especially oil-producing countries) whose currencies or economies were based on the American currency. This effective abandonment of the Bretton Woods system of fixed exchange rates was to prove problematic throughout the international arena. The second contributing event was a direct response to this action: oil-exporting countries raised the price of oil, precipitating the oil crisis of 1973-1979.

8. In the mid 1970s, developing countries, encouraged by developed countries to grow cash crops, suddenly found that these weren't bringing in the revenues they were used to for the raw materials they sold, like copper, coffee, tea, cotton, cocoa. The continuation of the world oil crisis and its effects on developed countries meant that there was decreasing demand for products from most developing countries, so while the oil prices skyrocketed, other commodities' prices dropped – lowering the terms of trade by more than 30% for regions like Sub-Saharan Africa. In an attempt to increase incomes, many developing countries harvested more for export. However, too many countries were producing and exporting the same types of commodities which flooded the market and led to even more radical drops in commodity prices, severely reducing developing countries' incomes. With the continuing decline in commodity prices, the terms of trade simply worsened for the developing

countries, a movement which would soon precipitate the start of the debt problem.

9. Trends in the international system were clearly building towards an eventual world-wide crisis. However, whereas developed countries would survive to lick their wounds and move on, developing countries did not have the measures in place to recover from these external shocks. The sharp deterioration in the international economic environment during this period was simply too much for the unstable economies of developing countries to handle.

10. The conditions of the world economy in the 1970s became such that embarking on extensive borrowing on the part of developing countries was understandable and, to some extent, even encouraged. Borrowing in general was viewed as a means of overcoming two main problems that developing economies were facing: that of the gap between export earnings & import requirements and that between domestic savings & investment needs. Such borrowing could add to the total resources available which could potentially lead to economic growth and poverty reduction. As would be seen later however, in most cases instead of enhancing growth rates, such borrowing lead to a virtual cessation in growth, with far-reaching economic, social, and political implications for the recipient countries.

11. The widespread extent of loan overtures and acceptance in this period is exhibited in the fact that developing country debt increased tenfold in the 1970s, with banks becoming aggressive in their loan offerings, reaching around the globe. The conditions of the global economic system at the time involved soaring interest rates on those loans, increasingly affecting the future ability of loan recipients to service their debts.

12. These world-wide events in the 1970s – recessions in developed countries, the oil price shocks, and weak commodity prices - were major contributors to the poor trade performance of the developing countries. Countries partly compensated for declining terms of trade with increased foreign borrowing, some even resorting to new borrowing simply to service debt. As funds for new investment dried up and economic growth slowed, debt dynamics were set off that became unsustainable in many cases.

13. Another main contributing factor to the evolving debt problem was the application of extensive protectionist measures on the part of the developed countries. High tariffs characterised the import of developing country goods into developed markets. With tariffs often being too high to absorb, let alone make any profit from, many developing countries were effectively denied any international market access. With negligible profits and minimal assistance to get out of this bad situation, more and more countries had to take out new loans just to pay the interest on existing loans.

14. What caused the actual debt 'crisis' to erupt however, was Mexico's devaluation of the peso and subsequent default on its debt payments in 1982.

This was viewed as the watershed moment in the continuing debt problem, even though other countries had already encountered similar problems (some African countries in the 1970s and Poland in 1981). However, since Mexico had been viewed as a ‘safe’ destination for loans, its default rocked the lending industries, which subsequently cut back on issuing new loans to other developing countries.

15. The Mexican experience threatened the whole international credit system, with other countries soon teetering on the brink of default. As problematic as this situation was, extenuating circumstances were to develop that would prolong the crisis. Trying to recover from the mounting defaults, creditors refused to give out new loans ‘freely;’ attached to them were demands for a variety of policy changes deemed necessary to avoid a repetition of events. To shore up the economies of defaulting countries, the IMF and World Bank stepped in, prescribing their loans with economic adjustment policies to ensure debt repayment. Requiring a reduction, if not elimination, of the domestic market protection measures in place in developing economies, the re-negotiated and new loans were increasingly impinging on the sovereignty of the recipients.

16. Private creditors would also play a role in the continuation of the debt problem through their own debt relief proposals. Mexico owed huge sums of money to banks in the U.S. and Europe, which joined together through the ‘London Club’ and with the support of the IMF, organized a scheme to spread out or reschedule the debts. Since the debt crisis was originally viewed as temporary, initial debt relief took the form of payment rescheduling, thus providing assistance primarily through a postponement, although sometimes with a reduction in debt stock and service obligations.

17. This pattern was repeated over and over in the following years as other countries found themselves in similar situations to Mexico's. Any supposed debt relief proved insufficient: debts continued to rise, and new loans simply added to the burden. In fact, even in combining existing debt relief, offers of new aid, and policy advice designed to reduce the need for loans, the debt was unable to be brought down to sustainable levels. Countries simply continued to borrow to repay old debts and the debt crisis advanced.

18. Clearly, there were major structural imbalances in the global economic system at that time. The divide between developing and developed was widening through production, consumption, and income distribution variances. This only worsened through the poor economic conditions of world trade and finance leading to foreign exchange volatility and higher interest rates, both of which would have effects on the ability of developing countries to service their debts. At the end of the 1970s, the global economy was such that resources were effectively being transferred from the developing to the developed, through sinking commodity prices, rising interest rates, and unbearable debt payments.

III. The Relationship Between Trade and Debt

19. As much as some might like to deny it, trade and debt are inextricably linked, as shown briefly in this historical background. Debt has its roots, in fact, in the tradition of unfair world trade which ignores the different levels of development and the need for preferential treatment of weak partners.

20. The relationship between debt and a poor trade performance is cyclical and self-perpetuating, in part because debt constrains the capacity to trade, which in turn reduces revenues and adds to the debt burden. The poor trade performance of developing exports can be directly linked to their unsustainable debt levels as the reduced earnings resulting from declining commodity prices hamper the ability to meet debt servicing obligations.[2] Likewise, increasing debt service payments are a drain on resources needed to enhance trade capacity. When debt-service payments are high and earnings from trade are low, debt thus ends up being both a cause and a consequence of poor trade performance in developing countries. The proof of this comes in the increasingly worsening debt burden suffered by countries that simultaneously suffer from adverse terms of trade.

21. Poor trade conditions also have less direct effects on the debt burdens of developing countries and vice versa. Poor terms of trade can affect the ability of developing countries to generate the foreign exchange needed to buy essential imports which could be used for improvements in export capacity. Debt can also deter private capital flows, reducing funds for investment in better performing trade sectors. Furthermore, debt poses considerable constraints on future economic policy. If countries want to pursue economic policies geared towards helping their people – i.e. through education, health, or infrastructure services, they are constrained by their debt. The money that should be going to development initiatives thus gets diverted to debt servicing.

22. The poor terms of trade experienced by the developing countries have also suppressed their capacity for economic growth. This links to debt as well since many developing countries have had increasing difficulty making payments on their debts, mainly because they have not grown as rapidly as anticipated. Furthermore, the existence of a debt overhang prevents future growth and development since many developing countries spend more on debt service than on needed social or development-oriented services. Clearly then, if one is to believe in a link between trade and growth, a relationship between trade and debt is not a far stretch of the imagination, if only because debt financing impinges on growth. The problem apparent in this linkage between trade and debt is that when poor countries become deeply indebted they fall

[2] Under the current conditions of the global economic system, not only do low primary commodities prices contribute to developing countries' poor terms of trade, but, as will be shown later, the role of their manufacturers in the system also contributes to the debt problem.

into an abyss of economic degradation, perpetuated by the cycle of poor trade and debt.

23. The inherent imbalances in the global economic system that allow for this cycle of poor trade and debt were not only never rectified, but were institutionalized. Many developing country governments now owe vast sums to developed country governments and international financial institutions. These institutions, predominantly controlled by those same developed country governments, have taken on the responsibility for determining, not only the levels of debt relief, but also the rules of trade for the debtor countries. Such trade rules and other trade-related advice from international trade and financial institutions therefore play a significant role in the trade-debt relationship as well.

24. International institutions contend that the continuation of conditions of poverty, economic instability, and subsequent debt burdens in developing countries and LDCs is due to their low level of integration in the global economy which is itself due to their failure to adopt sufficiently open trade regimes. However, it is more the manner in which these countries have been integrated that is responsible for their situation today. Asked to lower or remove nearly all tariffs and non-tariff barriers to trade, developing countries relinquished what little safety measures they had in place to ensure minimal profits. In addition to these customs concerns, developing countries were persuaded to develop and diversify their economies, regardless of their capacity to do so. The idea behind this recommendation was that by complete integration in the world market, developing countries would be able to increase exports and therefore incomes and be able to pay off their debts. Taking their cue from the international financial institutions, and later the international trade institution, creditors also began demanding the immediate entry of developing countries into the world market, in the hopes of assuring repayment. As would become more apparent as the years went on however, this demand for openness was one-sided. While championing free trade, the developed were nevertheless closing their doors to trade from the developing so that, for developing countries, the ‘free market’ simply transferred resources from the South to the North, whether through debt or through trade, through the IMF/WB or the WTO.

25. The shift to freer trade had other serious consequences for the developing countries. Part of the requirements attached to loans pressures developing countries to increase their exports in order to accumulate the foreign currency needed to make their debt payments. Given that many developing countries export the same types of goods to this widened market, following this policy advice leads to a swelling of supply of these goods, drastically reducing the prices for these goods. This is complicated by the fact that any move to diversify production is hampered by debt payments, which reduces money for investment in new areas of trade to escape export competition with other developing countries. The more they try to export, the farther the prices drop

and the less revenues come in, trapping them in a debt & poor trade-induced low-income cycle.

26. In general, international trade rules and regulations have left developing countries more prone to financial instability and have not aided in any concrete way the struggle to change their terms of trade. This differs tremendously from the effect of the relationship between trade and debt for developed countries. Developed countries experience a more positive relationship: well-integrated in the world economy and able to export diverse products with often high revenues, developed countries can meet their debt payments through their export profits without affecting domestic spending; they can maintain sustainable levels of debt. This is partly due to the inherently biased structural relationship between the North & South in world trade, a harmful rapport deliberately maintained by the North. This is not to mean that the negative relationship between trade and debt for developing countries should be overlooked by the developed. In fact, all should be concerned about the effect the relationship has on international trade in general, because there is a recurring negative impact on the growth of the world economy, and naturally on that of the developing countries in particular, in the existence and continuation of such extreme debt.

IV. PRESENT SITUATION

27. Today, this trade-debt linkage is even more pronounced, with many developing countries facing enormous external debts, a condition unlikely to be rectified if their poor position in the world trading system is not improved. As of 2001, the total debt stock of all developing countries was about $2,442 billion. (World Bank, 2001).
28. The debt problem varies in severity by region. For the least-developed countries (LDCs) for example, the debt as a share of aggregate GDP was 89% in 1999, and in 2000, the total LDC debt was $143.2 billion. This amount reflected a reduction of $4.4 billion from the beginning of 2000 and one of $9.3 billion from 1999. However, as the share of LDCs in world exports and imports has been dropping, declining 47% between 1980 and 1999, the decrease in overall debt for the LDCs has had little lasting effect. (UNCTAD, 2002a). For other groupings, the outstanding debts were as follows as of 1999: $626,162 million for developing countries in the Americas (+17.6%); $251,833 for those in Africa (-1.8%); $920,113 for those in Asia (+23.4%); $4,636 for those in Oceania (-8.8%); and $20,621 for those in Europe (+284%). (UNCTAD, 2001).

29. There are a number of reasons why the debt crisis has continued and in fact, worsened. The overarching reason is that the terms of trade have not changed significantly for developing countries; the poor terms of trade in the 1970s were perpetuated and accentuated throughout the 1980s & 1990s. The levels of terms of trade for Sub-Saharan Africa and North Africa at the end of the 1990s for example, were 21 and 24 percent respectively below those attained in the 1970s. Sub-Saharan Africa’s share in world agricultural trade alone

dropped from a level of 8% in 1965 to a level of 3% in 1996. Additionally, the net barter terms of trade for developing countries as a whole with the E.U. declined at an average rate of 2.2 % each year between 1974 and 1994, with the largest decline occurring in the LDCs and the ACP countries -5.7% and -4.7% respectively. For the terms of trade with the U.S. between 1981 and 1997, the net barter terms of trade of manufacturing exports declined by 15.6%. (UNCTAD, 2002b).

30. Most recently, the events of fall 2001 and the resulting economic downturn experienced in the United States, but quickly felt world-wide, have also affected the economic position of the developing countries. Developing countries experienced a pronounced deterioration of about 30% in their terms of trade, once again victims of an external shock characterised by further commodity price declines, low or negative growth, poor export performance, and reduced capital flows & investment. (UNCTAD, 2002b).

31. Since the crisis of the 1970s and subsequent elevated borrowing by developing countries, the external debt burden has increased significantly. We have already shown that the build-up of debt resulted primarily from the external shocks of this era, followed by a continuance of the adverse terms of trade experienced by the developing countries which already tended to focus on a limited selection of export products. However, as time progressed, other factors helped to worsen the situation: the continued reliance on primary commodities and/or low value-added goods for export, the continued application of generalised and ill-conceived policy reform demands attached to debt relief, and the employment of inadequate debt relief mechanisms.

A. Continued Reliance on Primary Commodities and/or Low Value-Added Goods

32. As described earlier, developing countries have long relied on the export of primary commodities, many of which are agriculture-based, such as coffee, sugar, and tea. The main problem with this reliance is that the market situation for commodities has not improved over the years. Commodity prices fell 27.2% between 1997 and 1999, rising a mere 1.9% in 2000, only to drop another 2.9% in 2001. (UNCTAD, 2002b).

33. The commodity export sectors in developing countries and LDCs are characterised by low productivity and tend to involve low-value added sectors within which world demand is either slower than average or declining. Furthermore, LDCs especially are forced to rely on the export of unprocessed primary goods because of the threat of tariff escalation by developed countries. For this reason, the percentage of unprocessed primary commodities as a percentage of primary commodity exports has increased from 75.5% in the years 1981 to 1983 to 88.9% in the period from 1997 to 1999. Processed primary commodities, on the other hand, have experienced a decrease, with a 24.5% reduction between 1981 and 1983 down to 11.1% in 1997 to 1999. (UNCTAD, 2002a).

34. As noted, basic structural weaknesses resulting partly from their situation in the global economic system make developing countries more vulnerable to external shocks. Since their economies are largely based on commodities, shocks in commodity prices greatly affect income, making governments less certain about how much revenue they will have each year to afford imports, finance necessary development initiatives, or service their debt.

35. Following the theories of Prebisch and Singer, the terms of trade for primary commodities have been on a downward trend. This is due to the large fluctuations in the global commodity markets, which continue to be extremely volatile. Developing countries have suffered considerable foreign exchange losses due to declines in the commodity terms of trade. This also means that a larger volume of exports in required in order to finance a given volume of imports, creating balance of payments concerns with regard to potential investment. The continued dependence on this still narrow range of undynamic and low value-added goods is partly a result of the low levels of investment in physical and human capital. As noted earlier, under such conditions developing countries cannot make the income necessary not only to pay off debts, but also to invest in the diversification of production and other development strategies. Moreover, being unable to adequately fund social projects, such as education, health, and training, affects the ability to move to a new production sector, as the country will then lack healthy, skilled labour. For this reason, few have had the opportunity to expand beyond this primary production and those who have, have moved into simple manufacturing, concentrating primarily on textiles and clothing, both low value-added goods.

36. Nevertheless, there are several perceived advantages to this move, in addition to this being an improvement on primary commodity exporting. According to Prebisch & Singer, the income elasticity of demand for manufactures is higher than for primary commodities. Therefore, manufacturers tend to not suffer from the same price volatility as primary commodities, largely due to there being less competition in this area and because appropriate responses to increases or decreases in demand are more easily made. This differs from the case of primary commodities because where, even if efforts to expand such exports were successful, the low demand elasticity for commodities would limit the potential income increases.

37. Since the revenues are higher and tend to be more secure for manufactures than for primary commodities, developing countries were advised by the international trade and financial institutions to diversify their export structures, embarking on a new production cycle. However, this was not an easy task as shown from the various aforementioned problems faced by these countries. In addition to the overwhelming debt burden, the fact of still being based in the primary sector and lacking significant income for investment, meant that the possibilities for accelerating development which could modernize industries to escape the primary commodity curse were limited.

38. Some developing countries and LDCs were nevertheless slowly able to invest enough to move to a new sector of production and trade: low value-added manufacturers. For their part, this was done in reaction to the clear problem of relying on the same zero or low value-added primary commodities that many contemporaries were also exporting.

39. Unfortunately, to a significant extent the shift simply moved them to the bottom rung of a different production process. Strangely, or perhaps understandably due to the condition of the world economic system, the stable manufactures were warped when in the hands of developing countries. In other words, the price stability associated with manufactures seems to end with developed countries, so that those exported by developing countries experience downward pressures on prices and the terms of trade. The export by Southeast Asian countries of computer chips is a prime example. Since chips form the base of a final product (a computer), they occupy the first stage in the production chain, but their value remains minimal in the bigger picture. For this reason, the shift to low-value added manufactures hasn't been too helpful, causing UNCTAD to note that the adverse terms of trade problems of developing countries now extends beyond primary commodities to manufactures.

40. Furthermore, the shift has not raised the real value of developing and LDC exports significantly. For example, seventy percent of LDCs' exports are primary commodities, and 30% are manufacturers, however only 3% of the later can be considered above low-skilled. In addition, while developing countries increased the number of manufactured exports to the world market, there wasn't a corresponding increase in value-added in proportion to their GDP: even though the volume of exports increased by 43% between 1986 and 1999, the percentage increase in value was only 26%. (UNCTAD, 2002a). This is because both those products exported from the primary sectors and manufacturing sectors of developing countries are low value-added and have low-income demand elasticities, even if one sector performs slightly better than the other. The manufacturers exported by developing countries are for the majority, the outcome of a low-skill and low value-added stage in the production process (which, in its entirety, is usually controlled by foreign TNCs). Thus the expansion of the adverse terms of trade for developing countries to the manufacturing sector was once again due the competition between exporters concentrating on similar resource-based or labour-intensive products and the limited resources for investment in more advanced production. Anticipated further industrialization along these new lines is unlikely to be guaranteed because the new exports are still low value-added and still generate relatively low incomes, preventing a move to higher value-added manufactures. This differs from the experience of the developed countries, whose manufacturing sectors are already higher value-added, and as explained above, do not suffer the same price/demand fluctuations.

41. This transition has had the unfortunate effect of the exports of this branching out into manufacturers behaving like primary commodities in many ways.

This is because the manufacturing production chain also carries problems and risks. As within the primary commodity sector, the expansion of manufacturing exports from the developing countries have also been associated with a downward trend in terms of trade – a trend much more pronounced with respect to exports of labour-intensive manufactures than skill- and technology-intensive products. With all or most developing countries encouraged to proceed along this path of diversification, it is natural that competition in manufacturing would reflect the competition in primary commodity exporting. Nearly 'universal' expansion and exportation of manufactures can flood the market just as easily as similar shifts in the commodity sector, forcing prices down, and placing the developing countries in the same position as before. Furthermore, due to protectionism and discrimination, this price drop is felt primarily by developing countries, as there tends to be more demand for developed countries' manufactures.

42. Protectionist international trade agreements have also played a role in the poor results of this shift. Countries which moved into manufactures have largely concentrated on textiles and clothing, both of which have been heavily regulated under the Multi-Fibre Arrangement (MFA). The MFA allows developed countries to impose quotas limiting imports of clothing and textiles from developing countries. Although required to be phased out in accordance with the WTO Agreement on Textiles and Clothing, this has been delayed in the past, so these sectors may continue to face challenges.

<u>B. Continued application of poor policy reforms attached to debt relief</u>

43. As noted earlier, all new loans and any debt relief have come attached with 'strings' of policy reform requirements directly related to trade. With each new loan or debt relief mechanism comes a variety of measures which are to be implemented in order to assure continued financing and/or any consideration of debt rescheduling, diminution, or eradication. The trade-related policies demanded are often more profitable for the developed than the developing, largely in part due to their inappropriate focus on increased trade rather than increased development. If only for this reason, the denial of the existence of a relationship between trade and debt seems foolish.
44. Moreover, these conditions for credit have more and more had the aim not of development, but of repaying the debt. By attaching such conditionalities to the loans, creditors assure themselves that the debt will be serviced (in one way or another – i.e. they might not get 'cash back', but they could be assured newly open markets). Sadly, these conditional measures have turned the terms of trade worse for developing countries, with the burden of debt and its accompanying demands of economic adjustment falling heaviest on the poor.

45. More evidence of the effect of this particular characteristic of developing countries' trade-debt cycle will be offered in Section 5.

<u>C. Other Terms of Trade Problems</u>

46. Other problem areas for developing countries with regard to their poor terms of trade and continuing debt burden include protectionist and discriminatory policies employed by developed countries and sanctioned by the international trade and financial institutions, and poor and unreliable investment.

1. Protectionism & Discrimination

47. 'Free trade' has been espoused as the way for developing countries to encourage growth and therefore to eliminate or at least reduce the burden of debt. However, this call for free trade is asymmetrical and reflects the fact that the institutions which determine international trade policy (WTO, IMF, & WB), are largely in the hands of the developed nations. Double standards and hypocrisy thus prevail. While demanding free access to the economies of the developing world, developed nations have been less inclined to offer the same access in their economies. Instead, they employ tariffs and non-tariff barriers to reduce the number of developing country goods entering their markets. These barriers are often higher than those encountered by rich countries and end up costing the developing countries U.S.$100billion a year in lost potential income, an amount nearly twice as much as that offered in aid. (UNCTAD, 2002a).

48. What obstacles to free trade have been removed have had little effect on developing countries' interests. Instead it is predominantly in those areas of prime importance to developing countries (notably agriculture, textiles, and clothing), that trade liberalization has progressed the slowest. Market access to these sectors in developed countries remains quite restricted in comparison to other sectors which fall quite beyond the means of developing countries' export capabilities. As argued in vain since the 1960s, it would seem apparent therefore that under international trade policies, market access restrictions have been made permissible for industries in which only developed countries have the competitive edge. These skill- and technology-intensive sectors have little in common with the needs or capacities of agriculture and/or low value-added manufacture exporters who require free access and entry to markets in kind.

49. This call for liberalization has involved a plea to remove tariffs and non-tariff barriers to trade. However, developed countries continue to employ various non-tariff barriers as a protectionist tactic. Such discriminatory protectionist devices are evidenced in the trend of tariff escalation. Under this scheme, a developed country will limit or even remove tariffs from imports which form the basis of potential products, but then 'escalate' tariffs to keep out the processed versions of these imports. As one of the most effective ways in which developing countries can escape dependence on volatile primary commodity markets is to add value to their exports through local processing, tariff escalation proves to be a valuable form of market protection for developed countries. It forces developing countries to remain in the primary stage of production with the threat of facing increasingly significant tariffs in accordance with each advancement in the production chain. The effect of this

has already been shown in the decline in processed commodity exports by developing and least developed countries.

50. Escalating tariffs are just one way in which developed countries protect their own industries and thus prevent developing countries from establishing a manufacturing base to get them out of the primary commodity curse. Other forms of protectionism employed by the developed cover a wide spectrum of policies: tariff peaks and quotas; anti-dumping and countervailing duties imposed on imports; unjustified sanitary and phytosanitary import restrictions; and export, production, and investment subsidies for agricultural and industrial products. These all serve to generate distortions against developing country exporters and can even have adverse effects on their domestic markets.

51. The use of subsidies in developed countries can leads to the overproduction of a given product, driving prices down and providing an incentive to dump those surpluses on world markets. This has severely worsened the volatility of commodity prices for developing countries. Producers in developed countries, however, remain protected from these price swings through subsidies and other agreements such as the E.U. Common Agricultural Policy (CAP) and the U.S. Farm Bill. All the change in price in response to natural fluctuations in commodity prices must therefore be borne by developing countries - countries that are already suffering from markets which have been flooded by cheap exports as a result of the excess production in the developed countries. Other policies have also put producers in the developing world at a severe, and deeply unfair, disadvantage. In agriculture, for example, the U.S. provides assistance to its domestic sugar industry through price supports and import restrictions that make the majority of developing countries' sugar exports face tariff rates of nearly 150%. Low value-added manufacturing subsidies and accords like the Multi Fibre Arrangement have also restricted the growth in developing countries' exports. Were such subsidies and other non-tariff barriers to be removed, a considerable fall in production could result, leading to a rise in the world market price for the goods, and a substantial increase in revenues for developing countries.

52. Clearly the maintenance of such protectionist and discriminatory tactics will only ensnare developing countries further in their poor terms of trade. Forced to implement in full the commitments of the Uruguay Round, but facing restrictions on market access in many developed markets, developing countries are suffering from large payments deficits which only serve to entrench their debt burdens. The debt problem has significantly worsened due to these and other forms of trade protectionism and discrimination in the international economic system. For example, world trade is very lopsided: the E.U. and U.S. have 11% of the world's population but they account for 50% of world exports. The 49 LDCs, also with 11% of the world's population, have an export share of 0.4%.

53. The advantages of using these methods is clear: developed countries get to protect their markets from potentially competitive imports, but are assured

open access to developing country markets. However, there are significant downsides to the employment of these schemes for developed countries as well. These same countries tend to be the creditors for the loans and debt relief mechanisms for developing countries. In denying developing countries the means to pay their debts (by denying or limiting access to their markets), they assure themselves that the likelihood of timely debt payments, or payments at all, remains nil. Secondly, despite the obvious pluses to developed countries in using these methods, such schemes are detrimental to world trade as a whole. Not only does the usage of these mechanisms go against established trade rules, but it also distorts the pattern of world trade and can lead to inefficiency through lack of competition.

2. Irregular investment

54. In order to improve their terms of trade relevant to their debt burdens, developing countries need to achieve large enough volume increases to offset declining commodity terms of trade. Since this is not assured through the regular route of export earnings, this and the need to avoid protectionist and discriminatory barriers like those described above, require developing countries to be assured of stable and predictable investment. Unfortunately, the debt overhang in many developing countries has acted as a major deterrent to this much-needed investment, through fears of future default.

55. Investment's instability and unpredictability in developing countries has thus remained a problematic issue. Official net resource flows are on a downward trend and while private capital flows have increased, both are still unstable. The trends of net private capital flows are particularly volatile, ranging from \$59.6 billion in 1999 to \$8.9 billion in 2000 and \$20.1 billion in 2001. (UNCTAD, 2002b). This is due to changes in monetary policy and interest rates in developed countries and due to risk management decisions by investors and creditors. Importantly, the level of capital flows largely dictates the import and export diversification capacities of developing countries. Infrequent financing can effect exchange rates as well, resulting in large fluctuations among currencies.

56. In conclusion, the debt burden has become so onerous as a result of insufficient market access, poorly-planned economic policy reforms, protectionism & discrimination, and unreliable sources of investment, that even were some debtors still willing to maintain the conditions of debt service obligation, they are simple unable to. Moreover, debt and the inability to repay the debt have effectively crippled many developing countries, causing them to divert resources needed for development initiatives to servicing their debts.

V. ROLE OF INTERNATIONAL TRADE SYSTEM & INTERNATIONAL FINANCIAL INSTITUTIONS

57. In addition to the aforementioned problems, the global trading system and the international trade and financial institutions could be deemed to contribute directly to the debt problem. Whether this is through explicit actions on their part or through inaction will be shown below.

A. Global Trade System

58. The idiosyncrasies of the global trade system allow for exchange rate flexibility to be favoured over stability, adjustment over financing, and creditors over debtors. As a result, it is a condition of the system itself that has permitted the perpetuation of the debt crisis.

1. Trade Aspects

59. There are three main areas that figure in the trade side of the global system which are of importance to the debt problem: the general terms of trade, the issue of balance of payments, and the maintenance of trade barriers to developing countries' goods. As mentioned earlier, poor terms of trade for developing countries are an implicit result of the global trading system. Relevant terms of trade issues already touched upon include the continued reliance on the export of primary commodities and poor policy decisions. Even though a shift to low value-added manufacturers has changed the composition of developing country exports, the continuance of poor terms of trade reflects the position of developing countries vis-à-vis developed countries in the world production chains.

60. A second systemic issue concerns the gap between export earnings and import needs. There is a clear relationship between the balance of payments of a given developing country and the extent of its debt burden. With a balance of payments surplus, debt servicing is financially feasible. Many developing countries thus embarked on a move towards greater export production in order to increase revenues and achieve a balance of payments surplus. However, as noted, even in producing more goods for this aim, developing countries are not guaranteed their export due to the negative conditions of the global trading system. In addition, trying to reduce imports in place of increasing exports is often not a viable solution nor even possible due to international trade rules, if attempted in a manner that uses tariffs or non-tariff barriers.

61. Moreover, even an increase in developing countries' exports is unlikely to generate the income necessary to purchase essential imports because of their debt burdens. This puts them in a chronic balance of payments deficit with more goods being imported than sold abroad. This persistent and large negative balance of payments problem continues mainly because developing countries need to purchase many foreign goods and services, but are unable to export enough to pay for these imports. Borrowing can correct a balance of payments deficit in the short term, but if continued, only seeks to worsen the problem because, if there is little or no growth in exports, income, and therefore revenues, a country will not have the capacity to service their debt

over the long term. Developing countries therefore suffer an unintended competition between exports and imports in rectifying balance of payment and debt problems.

2. Financial Aspects

62. While the primary focus of this paper has been on the relationship between trade and debt, factors from the financial structure of the global economic system clearly come into play as well. In fact, the vicious cycle of trade and debt can just as easily be extended to include finance.

63. There is a clear relationship to debt in the composition of the financial arrangements that characterise economic relations. Fluctuations in financing (i.e. if financing is not predictable and the cost of financing is high), can cause the debt to worsen. The existence of limited and irregular financing has a negative effect on exchange rates as well, often resulting in ill-equipped responses to wide exchange rate fluctuations.

64. Exchange rate fluctuations, misalignment of exchange rates, and currency depreciations, while out of their hands, nevertheless have severe impacts on developing countries. They have an effect on the relationship between trade and debt, and may actually cause an increase in the external debt burden. Most developing countries' economies are tied to the major currencies (U.S.$, Euro, Yen). Exchange rate changes among these currencies have thus contributed to the increase in the debt burden due to the debts being based on these major currencies. Fluctuations can also affect the ability of developing countries to service their debts, as this must be done in the same currency as the loan was given. The servicing of debt in foreign currencies absorbs budgetary and foreign exchange resources, putting a tremendous strain on developing countries with regard to providing their people with basic social services (healthcare, education, and infrastructure) and needed development programs.

65. Fluctuating exchange rates distort trade flows in general. Moreover, the volume of these fluctuations affects global trade as a whole and therefore should be of concern to developed countries as well. Sending incorrect price signals, exchange rate fluctuations can cause the revenues on exports to decrease and the cost of imports to increase or vice versa, altering the competitiveness of individual industries on the world markets.

66. Currency fluctuations also have the potential of triggering trade frictions and protectionism. Often, these exchange rate fluctuations are responsible for trade price distortions, effectively cancelling out any benefits of free trade. In this situation, subsidies and tariffs can be employed as corrective measures. The problem, of course, is that current world trade rules forbid developing countries (the main sufferers from exchange rate volatility) from using these methods of protection. Developed countries are technically forbidden as well, although their lack of express sufferance from this situation negates the need.

(Importantly, this has not seemed to have prevented developing countries from employing these methods.)

67. All of these financial problems make both importing and exporting difficult and, when ill-prepared as many are, serve as external shocks to developing economies, reducing capital flows and increasing debt burdens. This volatility can spread to other sectors, creating inflationary pressures, and in general hampering the capacity of countries to repay their debts.

B. International Institutions

68. As made clear earlier, the World Trade Organization, International Monetary Fund, and the World Bank primarily serve the interests of the developed countries. The policies they enforce are in fact to a large extent designed solely by developed countries.

69. In the case of the WTO, its trade rules have been imposed in developing countries more so than in developed countries. Additionally, in focusing on free trade and market access as the main aims rather than debt sustainability and development, the WTO is clearly continuing to work in the interests of the developed countries. The WTO has made little leeway towards capacity building for the developing countries, which continue to have little or no say in negotiations. Developed countries subsidies are actually being endorsed by the WTO in its inaction to react appropriately. The Common Agricultural Policy of the E.U., the U.S. Farm Bill, the U.S. Steel Bill, and the use of quotas, import tariffs, and price-support mechanisms by these and other developed countries, continue to be ignored by the WTO. As for the IMF and WB, the most important and powerful multilateral lenders, their structural adjustments and conditionalities have only worsened the terms of trade and debt problems of developing countries.

1. International Trade Rules

70. The main policy put forth by these institutions is the mantra of free trade. Believing that trade liberalization plays an important role in restoring economic stability and a viable international economic position, the policies of these institutions demand adherence to this belief from all players.

71. With claims of developing country needs and interests at heart, the WTO for example, claims that a liberalized trading policy can help strengthen the balance-of-payments situation in a given country because it has the potential of improving the competitiveness of exports. The international trade and financial institutions also claim that in the long run, this liberalization will help stabilize the exchange rate problem faced by developing countries, while admitting that this same policy is responsible for ‘initial’ exchange rate instability. Yet exchange rates are still volatile; and that is why the problem of debt is most severe because these countries are facing unsustainable debt

burdens now, burdens which are being aggravated daily by continued exchange rate instability that does not seem near to ending.

72. Moreover, developing countries, by virtue of their types of exports, face far more competition than developed countries once immersed in the 'free' world market, and continued protectionist policies in many developed countries have kept in place tariffs or non-tariff barriers to developing country trade. International trade rules have thus directly favoured developed countries by giving preference to products and sectors in which they have an edge and ignoring their limited liberalization. Tariffs, subsidies, anti-dumping clauses, product standards, and tariff escalation are used against products to which some developing countries have diversified, but forbidden to be used against products of developed country interest. While developed countries keep their markets closed through the use of these protectionist measures, developing countries continue to be pressured by the international financial institutions to open their markets, and as rapidly as possible. The 'free' market, while requiring obedience to existing WTO rules – rules devised not in the interest of the developing countries, seems to turn a blind eye towards the blatant overstepping of these rules by the developed.[3] The evidence thus clearly points towards unfair and not free trade.

73. There is clearly some inconsistency going on here in the policy advice given by the international finance and trade institutions to developing countries. Seeking import liberalization and export-oriented growth strategies through the application of conditionalities to loans, yet overlooking the protectionism in many developed countries' markets, these organizations are not working in everyone's interests. Instead of using their economic power in an equitable way, these institutions have put in place policies which are clear detriments to developing countries' growth, making them adhere to these polices, while ignoring the lack of adherence to these policies on the part of the developed. As a result, major products of developing countries still face barriers. This is a reflection of the lack of true democracy within the international finance and trade institutions – whether as a result of the income-based voting in the IMF and WB, or of the negative consensus in the WTO. With developing countries clearly lacking ownership of these institutions, it is no wonder that developed countries have been able to use these organizations to dictate economic policy to developing countries.

74. While the WTO has studied and perhaps even put into effect policies to ameliorate the situation of the developing countries, it has failed to address their primary concern: the continuing decline in the price of commodities, their main if not only exports. It has also failed to prevent developed countries from maintaining barriers to exports from developing countries.

[3] It should be noted that while developing countries have the right to complain by bringing a case before the Dispute Settlement Body (DSB), the condition of the world economic system with the developing countries finding place at the bottom of the chain, inhibits their resolve for fear of retaliation (as well as their chances of winning), were they to fight in the first place.

2. International Monetary Fund & World Bank Debt Relief Mechanisms

75. The international trade and financial institutions also control the conditions of debt relief in developing countries. This is largely through their power and influence which allows them to withhold loans on the basis of non-fulfilment of the economic conditionalities they deem necessary to avoid future default. The problem with multilateral loans as compared with those proffered by individual lenders or banks, is that the former come with certain requirements that must be met before any consideration of offering new loans, payment reschedulings, or other debt relief.

76. When first faced with default, the World Bank and the International Monetary Fund agreed to lend debtors more money to repay existing debts, but the loans only added to the debt burden with their conditions. These policies have not helped to diminish the debt directly, i.e. by fixing export and terms of trade inequalities. This is largely because they have as their aims increased & freer trade and debt servicing, rather than development, which once accomplished, would ideally preclude the need for debt relief. Moreover, if development is truly an aim of the international trade and financial institutions, as they claim, they must take into account not only how protectionist trade regimes and inadequate assistance impede development, but also the effect of heavy debt burdens on this aim.

77. In addition to the providing of new loans to pay off old ones, the international trade and financial institutions have created various mechanisms for aiding developing countries in relieving their debt burdens.

78. The largest effort made to provide debt relief on a wide basis is the Heavily Indebted Poor Countries (HIPC) Initiative. The HIPC Initiative was launched by both the IMF and WB in 1996, with the aim of resolving the debt problem of the most heavily indebted poor countries. HIPC required the participation of all creditors, whether bilateral, multilateral, or commercial. Moreover, the HIPC involved policy direction, debt relief, and new aid.

79. However, even this supposedly groundbreaking debt relief mechanism came with strings attached, and therefore was not without problems. The first complication of the HIPC Initiative concerned the eligibility criteria, which were quite tough. First the level and condition of the debt had to be judged unsustainable; in other words, the debt could not be able to be serviced through export earnings, aid, capital inflows, or other available debt relief mechanisms. However, the HIPC uses economic figures alone for determining the sustainability of a debt, without taking into account the human development issues at stake, and therefore its preliminary assumptions are flawed. Secondly, the candidate country must prove a significant record of economic policy reform. Even some countries deemed to fall under the heading of heavily indebted and poor and carrying the burden of sustainable debt have nevertheless been unable to fulfil this criterium.

80. The HIPC process also was effective in narrowing down the list of eligible candidates throughout the process, as requirements had to be met by certain dates in order to proceed further. Only once they had clearly shown a commitment to reduce existing economic imbalances and carry out growth-oriented polices by adopting additional adjustment and reform programs as advised by the IMF and the WB, did candidates reach the 'decision point.' This fact is problematic in itself. At the end of this period, an analysis was made of the current sustainability of the debt, and depending on the conclusion, the country was either deemed eligible or ineligible to proceed further. As will be discussed below, debt sustainability analysis by the international trade and financial institutions has proven to be incorrect, so many prospective candidates were forced to leave the program at the decision point. If somehow found eligible, the developing country would undergo a phase of debt reduction, followed by another period of enforcing the international institutions-recommended economic policies, to reach the 'completion point.'

81. Even the IMF and WB have admitted the failure of the HIPC, necessitating its revamping in 1999.[4] HIPC had clearly set unrealistic goals which did not seem to be based on the past economic trends of the HIPC countries and, like Structural Adjustment Programmes (SAPs) before it, seemingly ignored the individual needs of the countries in question.

82. With the aim of making the program more need-specific in mind, HIPC II, as it was called, required countries to submit Poverty Reduction Strategy Papers (PRSP). PRSPs were an effort to individualise debt relief, differing from the across-the-board SAPs, and the poorly-planned original HIPC. In order to receive debt relief, developing countries would have to draft PRSPs themselves, adhering to the World Bank Comprehensive Development Framework's 14-point checklist and noting specific problems, needs, and goals for overcoming the debt problem. While this constituted a move to give developing countries a bigger role in the debt relief creation process, the requirement of these papers in order to be considered for debt relief serves as an elimination clause. Investigation, consideration, analysis, and prognosis of the debt problems of a country requires a tremendous amount of analysts and work – a task which has proven beyond the capacities of even the rather well-equipped international trade and financial institutions. Understandably, this is also quite often beyond the capacity of many developing countries.[5]

83. Apart from drafting the PRSPs themselves, debtor countries would have to enter the world trade system immediately, promoting exports and removing barriers to imports. In theory, this would help them increase revenues to repay

[4] "*Even [the] full use of traditional mechanisms of rescheduling and debt reduction—together with continued provision of concessional financing and pursuit of sound economic policies—may not be sufficient to attain sustainable external debt levels within a reasonable period of time and without additional external support*." (IMF, 2002)

[5] It should be noted that technical assistance has not played a sufficient role in improving this area either.

their debts (as if that was the only thing that mattered). However, most of the HIPCs have an oddly 'comparative' advantage in unprocessed primary products. This forced liberalization, which actually moves developing countries further along the free trade spectrum than their developed competitors, only serves to make them more dependent, not less, on primary commodities. Moreover, with increasingly plummeting prices for their products, only aggravated by exposure to the world market now shared by other similar product-exporting countries, all developing countries actually earned less once the cost and the end result of removing or reducing tariffs and non-tariff barriers to trade was factored in. (Greenhill, 2002)

84. Markedly, HIPC II carried over from the original initiative some of the same problems. The major carry-over is the continued use of export statistics and growth rates to determine future action on debt relief. The problem with this is that the growth assumptions used by the IMF and the WB have tended to be overly optimistic. Gunter (2002) has noted that in applying such over-optimistic growth rates, debt sustainability itself is effected, because it implies overly optimistic export rates and underestimates future financing needs.

85. The cyclical relationship between trade and debt is reflected within the results of these assumptions as well. Price shifts which, as noted, occur often and randomly in the commodities markets on which developing rely, affect the debt to exports ratio, a statistic used by HIPC II in measuring debt sustainability. HIPC II defines debt as unsustainable when this debt to exports ratio is over 150%. With export earnings frequently changing, the IMF and WB can only make inaccurate predictions of an HIPC's future capacity to make debt payments and therefore may not grant sufficient debt relief. Since dramatic shifts in commodity prices were experienced over 2000-01, particularly for coffee and cotton (which fell by 60% and 10% respectively), falling commodity prices once again pushed most of the HIPC countries off track in hitting the IMF/WB debt-to-export targets. (Greenhill, 2002). With HIPC countries all simultaneously attempting to increase exports as required by the initiative, more downward pressure is put on the prices.

86. Despite predictions on which HIPC II relief was based, GDP growth in the developing countries (excluding China) actually fell from close to 5% in 2000, to little more than 1% in 2001. (UNCTAD, 2002b). Clearly these assumptions have not helped the developing countries either in advancing growth, reducing poverty, advancing development, or escaping the debt trap.

87. The effects of the HIPC II elimination clause are seen in the fact that as of March 2002, only 26 countries were eligible for HIPC, out of 42. Strangely enough is that for these 26 countries, debt service for the period 2001-2005 will likely be about 30 percent lower than that paid in the period 1998-1999. Two out of the 5 countries which have reached the completion point have still not reached sustainable levels of debt according to HIPC II's own criteria, and at least 8-10 of the remaining 21 countries which are between the decision point and completion point, are expected to echo that result. (Greenhill, 2002).

88. Furthermore, neither SAPs nor the two HIPC Initiatives have been effective in reducing the total debt of participating developing and least developed countries. Total debt stocks for HIPC countries[6] have actually increased since 1970, at which point they measured $6.7 billion, to 1999, when they accounted for $205.3 billion. While the amount of debt stocks decreased by 4.4% between 1998 and 1999, the amount had increased by a whopping 263.9% since 1980. (World Bank, 2001).

89. In general, the conditions of the global trading system and the policies of its international trade and financial institutions, have created, institutionalized, and perpetrated the continuation of the poor trade-heavy debt cycle for developing countries, and have resulted in a general worsening of conditions for developing countries with, for example, seventy African countries today now poorer than they were in 1980, and 43 worse off today than they were in 1970.

VI. RECOMMENDATIONS

90. Given the extent of the problems associated with the trade-debt relationship, developing and developed countries alike are advised to review various issues of concern which have vast room for improvement. Among these issues are the question of improved market access, the advancement of capacity-building, and better debt relief measures. Other areas for consideration include organizational reform, the establishment of an international commodity policy, concerted effort towards exchange rate stability, increased and more efficient special & differential treatment options, and improved investment.

A. Improve Market Access

91. Most-Favoured Nation policy across-the-board is a myth of the international trade system; in fact, asymmetry rules. If it were only in the form of special and differential treatment, this would serve development interests proclaimed by all, but in actuality, it is on the side of the developed as well, a fact which serves to hinder development even more. Current international trade rules are restricting market access for developing countries. Due to these remaining protectionist and discriminatory measures against developing countries' goods, the issue of market access must be re-examined.

92. As regards the issues of debt burdens, once a country is faced with a specific level of debt, it should not be required to fully implement particular

[6] HIPC in Africa: Angola, Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Congo, Democratic Republic of Congo, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Kenya, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sierra Leone, São Tomé and Príncipe, Senegal, Somalia, Sudan, Tanzania, Togo, Uganda, Zambia. HIPC in Latin America: Bolivia, Guyana, Honduras, Nicaragua. HIPC in Asia: Democratic Peoples Republic of Lao, Myanmar, Vietnam. HIPC in Middle East: Republic of Yemen.

agreements which include the maintenance of open markets. A debt overhang reduces export earnings, which are only accentuated when a domestic market is open to world imports. Importantly, it is only with sufficient developed market access that developing countries will be able to improve these export earnings.

93. For this reason, more preferential market access is needed. However, improved market access is commercially meaningless if it does not entail market entry. The mere granting of tariff preferences or duty-free market access to exports originating from developing countries does not ensure that the trade preferences can be effectively utilised by them, nor does it guarantee that non-tariff barriers will not be used instead. There are several reasons why market access does not equate market entry for developing countries. First of all, they lack security in their access to markets. The employment of tariff escalations and sudden policy measures on the part of the developed to protect their markets means that the developing countries cannot rely upon a stable export front for their goods. Secondly, policies like that of 'rules of origin,' restrict the use of imported materials and components which form a large part of developing countries' exports. Third, a lack of technical knowledge, human resources, and institutional capacity to take advantage of preferential arrangements which require in-depth knowledge of national tariff systems in various preference-giving countries, hinders the utilisation of any limited market access that is available. Finally, other non-tariff barriers consisting of quotas, technical & product standards, and sanitary & phytosanitary measures remain obstacles to developing countries' exports.

94. A provision of importance to market access that could effect developing countries' relationship between trade and debt is GATT Article XXXVIII: 2(c).[7] The GATT further notes, that "given the continued dependence of many less-developed contracting parties on the exportation of a limited range of primary products, there is need to provide in the largest possible measure more favourable and acceptable conditions of access to world markets for these products."[8] Article XXXVIII: 2(c) also refers to the relationship between developing country Members' export earnings and their need for adequate financial assistance for development: "there is a need for a rapid and sustained expansion of the export earnings of the less-developed contracting parties; there is a need for positive efforts designed to ensure that less-developed

[7] Contracting parties shall "*collaborate…in examining trade and aid relationships with a view…to promote the development of export potential and to facilitate access to export markets for the products of the industries thus developed*." ('General Agreement on Tariffs and Trade,' 1947/1994).
[8] 'GATT,' 1947/1994. Furthermore, "*commitments…developed contracting parties shall…accord high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to less-developed contracting parties, including customs duties and other restriction which differentiate unreasonable between such products in their primary and in their processed forms; refrain from introducing, or increasing…customs duties or non-tariff import barriers on products…of..interest…to less-developed…and refrain from imposing new fiscal measures…which would hamper…the growth of consumption of primary products…of less-developed countries*."

contracting parties secure a share in the growth in international trade commensurate with the needs of their economic development."[9]

B. Develop domestic capacities

95. The bargaining position and negotiating capacities of the developing countries need to be strengthened. One way of doing this would be through greater South-South cooperation and greater interaction with NGOs for information sharing. It is essential that South-South cooperation works to change the international approach to solving the debt problem.

96. Furthermore, domestic capacities with regard to WTO provision-implementation must be built-up with aid from special & differential treatment initiatives and technical assistance. Improvements in internal management of developing countries are necessary, both in handling development projects and in the various international policies affecting trade and capital flows that they are required to implement. Improved technical assistance is also needed to aid commodity-dependent developing countries and LDCs in diversifying their export base in order to graduate to higher value-added stages in the production chain, and commodity risk management advice for those as yet unable to diversify.

97. Secure and predictable technical assistance as well as financial resources will be necessary for the improvement of developing countries' capacity in a number of relevant areas. The supply capacity, the technology, the infrastructure, and the competitiveness of the export sectors of the developing countries must be improved; all measures which will require adequate funding and assistance.

98. Trade-related technical assistance and capacity building is crucial for to enhance the effective participation and the negotiating capacity of the developing countries and LDCs in the WTO and in other regional and sub-regional trade and finance negotiations.

C. Genuine Debt Relief

99. With regard to debt relief, three things are necessary: lenders and developed WTO Member countries must recognize the need for debt reduction rather than debt rescheduling; the use of instruments such as debt discounts, debt write-offs, and debt swaps should be employed more regularly; and the individual needs of debtor countries must be examined prior to the implementation of any new debt relief proposals.

100. There are a number of possible ways to deal with the debt burden. Refinancing (taking out a new loan), rescheduling (deferring payments), and restructuring (altering the terms of the loan) have to date been the most

[9] 'GATT,' 1947/1994.

common methods used. Refinancing, as has been shown, is clearly not the answer as it only serves to increase the level of debt. Debt rescheduling is not a complete solution either as it merely aggravates the problem due to the interest-on-interest effect, effectively adding to the amount of unpayable debt. An option which might provide a more durable solution to the debt problem would not only involve a rescheduling of debt service obligations but also a significant reduction in the total stock of debt. Scaling down the debts of developing countries and LDCs by a significant percentage would be an appropriate policy measure in view of these countries' poverty and high degree of dependence on depressed and volatile export commodity markets. This partial debt cancellation would clearly be in the interests of debtor countries, however the reluctant move in this direction reflects the fact that creditor interests carry more weight in the international economic system.

101. Some have suggested that, based on the poor effective performance of the HIPC Initiatives, the HIPC should be revamped again to create an HIPC III. This is a possibility, although the changes from HIPC I to HIPC II might not be considered significant enough to merit another effort. This marks a trend in debt relief 'enhancement' as the Structural Adjustment Facility was also amended to become the Enhanced Structural Adjustment Facility (ESAF) and then the PRGF in 1999. These 'enhancements' didn't help, so why would a third HIPC be the answer? A new system of debt relief should be considered instead.

102. A more realistic option therefore, given the nature of the economic system and the institutions running it, is the idea of debt swaps. This involves "swapping" the debt, or parts of it, for various domestic programs including 'debt for nature,' 'debt for aid,' or 'debt for equity.' Some debts could thus be transformed into investments for productive industries of the indebted country, particularly in the sectors that have been liberalized by that country. In such a situation the debt would effectively be 'sold' by the creditor through an investor to the debtor government in return for local currency to be used in projects in the country. Developing and developed countries alike should look to the establishment of such a debt swap mechanism, as it would help finance the export capacity of developing countries, and thus reduce the overall debt burden.

103. In any event, all future debt relief programs would need to be based on realistic growth assumptions, moving away from the overly optimistic presumptions of the HIPC. Among others, these would take into account the negative impact of wide-spreading diseases like AIDS and other health and social concerns. As previously mentioned, debt sustainability should be measured with a view to achieving sustainable development instead of simply repaying the debts. This would mean that debt sustainability indicators would, at a minimum, take into account a country's fiscal constraints in achieving their development goals.

104. The lack of an effective mechanism for coordinating aid inflows also needs to be addressed. Aid must be given predictably and invariably so that policies can be put into effect without fear of future disruption as a result of aid volatility. UNCTAD notes that "the combination of (1) the drive to reduce the budget deficit, (2) interruptions of aid flows when fiscal targets were not met or other policy slippages occurred, (3) rising debt service obligations, and (4) the proliferation of donor projects that were increasingly managed through parallel government structures, [have] disrupted development processes and eroded state capacities." (UNCTAD, 2002a). For this reason, future loans and aid need not only to be increased, but increased in a stabile and predictable manner.

105. Furthermore, future debt relief should keep the strings to a minimum. Conditionalities are often inappropriate models for national development and debt reduction. Moreover, some are mistakenly tied to non-economic domestic situations within the debtor countries, as if withholding debt relief would enable government reform. For example, the U.S. recalled its debt relief programs in Burma and Haiti based on the internal conditions of these two countries, meting punishment unjustly on the population which feels the brunt of the debt burden. For this reason, future debt relief should not be linked to unjust, negative socially-impacting conditionalities. In addition, the current donor-driven aid/debt service system should be eradicated; aid will not effectively promote development until it is used for development purposes rather than as part of a debt game. Many creditors have allocated aid to developing countries with the implicit aim of servicing the debt. Aid must instead be concentrated in under-funded activities that can provide high developmental returns, to be identified by the recipient countries themselves.

106. Finally, no matter what debt relief option is pursued, the question of ownership in its creation and usage needs to be resolved. The debt relief initiatives of the past (i.e. SAPs, HIPC) were designed and negotiated nearly entirely by developed countries; developing countries had little, if any say in the formulation of these initiatives. The borrowing countries must 'own' the programs they are expected to implement. Moreover future debt relief needs to be negotiated on a genuine case-by-case basis and focus even more than HIPC II has on the individual needs and capacities of debtor countries.

D. Other

107. Other areas of recommended action include reform of the international financial and trade institutions, as well as a return to the original aims and ideals of these and other organizations within the trade-debt sphere; the implementation of an international commodity policy to help stabilize commodity prices; further special & differential treatment options; and increased investment.

1. Organizational Reform

108. Organizational reform is perhaps a long-term strategy for dealing not only with the trade/debt relationship, but with the many sub-issues that have been shown in this paper to form part of that relationship. Several problems mentioned previously are clearly major ones which need to be resolved if a truly free international trading structure is to be put in place. In the Punte del Este Declaration, the multilateral trading system has shown its awareness of the financial and monetary instability of the world economic system, the existence of a debt problem, and the links between trade, finance, and development, the latter of which at least, is severely hindered by debt.[10] This acknowledgement of most, if not all, of the aforementioned problems faced by the developing countries has been repeated in other areas as well. Now it is simply time that they do something about them as stressed in GATT Article XXXVI: 2-5 & 7.[11] Existing trade agreements should be modified or amended with safeguards in order to address debt issue and financial instability, as should future trade agreements.

109. In any case, the WTO has to play a more active role in ensuring international financial stability. The design and the implementation of financial assistance mechanisms to countries whose trade is affected by unstable export revenues and major financial and monetary crises is essential. General policy measures could range from keeping movements in international interest rates and exchange rates to a minimum; to real openness of international markets for goods and services; and to stabilisation of commodity prices and earning. A better international trade and financial environment is, after all, in the interest of all members of the global trade system. Consideration of the following existing provisions could provide for

[10] *"Mindful of the negative effects of prolonged financial and monetary instability in the world economy, the indebtedness of a large number of less-developed contracting parties, and considering the linkage between trade, money, finance and development….[agree to]…increase the responsiveness of the GATT system to the evolving international economic environment….taking into account…the importance of an improved trading environment providing, inter alia, for the ability of the indebted countries to meet their financial obligations." ('Punta del Este Declaration,' 1986).*

[11] *"(2). There is need for a rapid and sustained expansion of the export earnings of the less-developed contracting parties. (3). There is need for positive efforts designed to ensure that less-developed contracting parties secure a share in the growth in international trade commensurate with the needs of their economic development. (4). Given the continued dependence of many less-developed contracting parties on the exportation of a limited range of primary products,* there is need to provide in the largest possible measure more favourable and acceptable conditions of access to world markets for these products, and wherever appropriate to devise measures designed to stabilize and improve conditions of world markets in these products, including in particular measures designed to attain stable, equitable and remunerative prices, thus permitting an expansion of world trade and demand and a dynamic and steady growth of the real export earnings of these countries so as to provide them with expanding resources for their economic development. (5). The rapid expansion of the economies of the less-developed contracting parties will be facilitated by a diversification* of the structure of their economies and the avoidance of an excessive dependence on the export of primary products. There is, therefore, need for increased access in the largest possible measure to markets under favourable conditions for processed and manufactured products currently or potentially of particular export interest to less-developed contracting parties….(7). There is need for appropriate collaboration between the CONTRACTING PARTIES, other intergovernmental bodies and the organs and agencies of the United Nations system, whose activities relate to the trade and economic development of less-developed countries*." ('GATT,' 1947/1994).

these improvements: the Tokyo Ministerial Declaration of 1973,[12] the Decision on Exchange Rate Fluctuations and Their Effect on Trade,[13] and the Marrakech Declaration.[14]

110. Additionally, the WTO needs to be altered to be properly representative of the interests of the majority, without any fears of repercussions. The aim of this particular reform should be to make ownership of existing and future policies universal. Most importantly, development has to be placed back in the forefront. Future debt relief should not be given with the sole aim of paying off debts; debt relief should focus on strengthening capacities for development so that debt as an option can be obliterated.

111. A refocusing from trade to development is in fact necessary in all of the international financial and trade institutions. Other organizations, like UNCTAD, should be allowed to act as originally intended: providing analysis of the development needs of developing countries; advice which would be taken into serious consideration when negotiating future agreements in international trade and financial institutions.

112. In general, there is a need to bring about greater coherence and to ensure that international arrangements in the spheres of trade, finance, and debt mutually reinforce each other to support sustainable growth and development, instead of imprisoning developing countries in their current quagmire of degeneration.

2. International Commodity policy

113. An international commodity policy seems to be an appropriate measure for assuring future stabilisation of commodity and low value-added manufactures markets of concern to developing countries. While little productive work has been completed in this aim, the need for some kind of policy measures has been acknowledged in the WTO through Part IV of the GATT.[15] In addition, the direct link between falling commodity prices and

[12] "*The policy of liberalising world trade cannot be carried out successfully in the absence of parallel efforts to set up a monetary system which shields the world economy from the shocks and imbalances which have previously occurred*." ('Tokyo Ministerial Declaration of 1973,' 1973).

[13] "*[Urges] that their concern regarding the relationship between exchange market instability and international trade be taken into account in ongoing efforts within the IMF to review the operation of the international monetary system with a view to possible improvements….keep under consideration…the relationship between exchange market instability and trade*." ('Decision on Exchange Rate Fluctuations and their Effect on Trade,' 1984).

[14] "*Greater exchange rate stability, based on more orderly underlying economic and financial conditions, should contribute towards the expansion of trade, sustainable growth and development, and the correction of external imbalances*." ('Marrakech Ministerial Declaration on the Contribution of the WTO to Achieving Greater Coherence in Global Economic Policy-Making,' 1999).

[15] "*…To devise measures designed to stabilize and improve conditions of world markets in these products, including in particular measures designed to attain stable, equitable and remunerative prices, thus permitting an expansion of world trade and demand and a dynamic and steady growth of the real export earnings of these countries so as to provide them with expanding resources for their economic development….diversification of the structure of their economies and the avoidance of an*

unsustainable debt stocks reflects a clear need for the Agreement on Agriculture to assist in resolving the agricultural commodity problems of developing countries.

3. Greater Special & Differential Treatment Options

114. The already weak and insufficient provisions on special and differential treatment for some of the developing economies have been further watered down by the conditionalities of the international financial institutions and creditors. For this reason, new and revised special & differential treatment options are necessary. The debt burden of developing countries requires flexibility on the imposition or maintenance of export and import restrictions under GATT and GATS. A 'debt threshold' should be established beyond which certain special and differential treatment provisions would automatically become operative.

115. Important with regard to special and differential treatment concerning the relationship between trade and debt for developing countries are the following: Article XVIII,[16] the Havana Charter,[17] the Marrakech Ministerial Declaration on the Contribution of the WTO to Achieving Greater Coherence in Global Economic Policy-Making.[18] In addition, GATT Articles XII and XVIII: B and GATS Article XII allow a Member to impose trade restrictions to safeguard its external financial position and its balance-of-payments. Part IV of the GATT is also of importance.

4. More Reliable Investment

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excessive dependence on the export of primary products." Further, "contracting parties shall…take action to provide improved and acceptable conditions of access to world markets for primary products of particular interest to less-developed contracting parties and to devise measures designed to stabilize and improve conditions of world markets in these products including measures designed to attain stable, equitable and remunerative prices for exports of such products." ('GATT,' 1947/1994).

16 *"The contracting parties recognize further that it may be necessary for those contracting parties, in order to implement programmes and policies of economic development designed to raise the general standard of living of their people, to take protective or other measures affecting imports, and that such measures are justified in so far as they facilitate the attainment of the objectives of this Agreement. They agree, therefore, that those contracting parties should enjoy additional facilities to enable them (a) to maintain sufficient flexibility in their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry* and (b) to apply quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development*." ('GATT,' 1947/1994).

17 "*…a contracting party that experiences a high level of demand for imports "may find that demands for foreign exchange on account of imports and other current payments are absorbing the foreign exchange resources currently available to it in such a manner as to exercise pressure on its monetary reserves which would justify the institution or maintenance of restrictions…*" ('Havana Charter,' 1948).

18 "*Trade liberalization forms an increasingly important component in the success of the adjustment programs that many countries are undertaking, often involving significant transitional social costs*." ('Marrakech,' 1999).

116. External indebtedness is related to the level of access to external private financing and the effectiveness of aid. It is precisely the unpredictability of financing and poor aid management that have contributed to the extremity of the debt burden. Furthermore, a debt overhang acts as a deterrent to investment.

117. For these reasons, all effort needs to be made to attract direct foreign investment to a maximum extent possible. External finance is necessary to enable countries to break out of the trap of debt and to initiate a sustained process of development. Aid also needs to be administered more effectively. Finally, unconditional aid should simply be increased to reflect the 0.7% of the combined GDP of all developed countries envisaged not too long ago.

118. Important provisions with regard to investment include GATT Article XXXVI: 6[19] and the Marrakech Ministerial Declaration on the Contribution of the WTO to Achieving Greater Coherence in Global Economic Policy-Making.[20]

VII. CONCLUDING REMARKS

119. The external debt situation of the developing countries has considerably deteriorated. Efforts to provide debt relief through initiatives such as the HIPC, have not been successful; much of its anticipated relief has been slow to come or hampered by seemingly unreachable eligibility criteria. The debt overhang therefore has not been removed and debt remains unsustainable for these countries.

120. The debt burden is such a problem now due to the persistence in accumulation of unpaid debt service obligations and reschedulings have had little positive effect on resolving this situation. The problem with such arrears is that they effectively stop economic development in its tracks. Responsible for the denial of future loans, trade financing, and sometimes even retaliatory measures on the part of the creditors, the presence of arrears is evidence that a country is simply incapable of paying its debt.

121. Trade is clearly a determining factor in the accumulation and continuation of debt if only because in the absence of official finance and aid, countries compelled to liberalize imports via the WTO rules are forced to borrow to finance the imports. Alternative trade measures could provide a

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[19] "*Because of the chronic deficiency in the export proceeds and other foreign exchange earnings of less-developed contracting parties, there are important inter-relationships between trade and financial assistance to development. There is, therefore, need for…collaboration between the contracting parties and the international lending agencies so that they can contribute most effectively to alleviating the burdens these less-developed contracting parties assume in the interest of their economic development.*" ('GATT,' 1947/1994).

[20] "*There is also a need for an adequate and timely flow of concessional and non-concessional financial and real investment resources to developing countries and for further efforts to address debt problems, to help ensure economic growth and development.*" ('Marrakech,' 1999).

solution to the unbearable debt burdens of developing countries, and end the poor trade-heavy debt cycle. Trade must be made to help resolve current debt problems, but also enable the avoidance of future debt and ensure finance for development. Any trade-related solutions should not be solely on the basis of special trade concessions to highly indebted countries which carry out the IMF/World Bank-prescribed economic reforms as is advocated by the developed countries.

122. Given the aforementioned problems associated with the relationship between trade & debt and debt relief, developing and developed countries need to reassess the aforementioned existing WTO provisions with a view to providing remedial measures and flexibilities within them, in addition to reconsidering existing debt relief options as administered by the IMF and WB. If a more stable and inclusive international monetary, financial, and trade system can be created, debt cancellation and better debt management installed, adequate and predictable levels of financial flows encouraged, and terms of trade and market access conditions enhanced, an end to the developing countries' trade-debt cycle could be in sight.

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