III. FUTURE TRADE FLOWS AND THE NEED FOR OPENNESS

South-South Trade: Developments in the 1980s and Policies for the 1990s

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Introduction

Is the promotion of South-South trade through intergovernmental cooperative action important for the achievement of export growth targets of developing countries in the 1990s? Trends in exports from developing countries in the 1980s show the relative sluggishness of South-South trade and the dominance and dynamism of developed countries as markets for exports from developing countries, particularly of manufactures. The prospects would seem a continuation of these trends, partcularly in view of the numerous institutional and other constraints to trade among developing countries.

In this article the developments in the 1980s are briefly described. The conclusion reached, contrary to what might have been expected, is the need for developing countries to increase trade among themselves as a proportion of their total exports. It is argued that market demand in developed countries is unlikely to be able to absorb export growth required to achieve the economic growth target of the increasing number of developing country exporters of manufactures. It is further argued that specific measures are required to provide the initial incentive to enable South-South trade to increase on a self-sustaining basis. The final section touches on possible intergovernmental co-operative action among developing countries in the area of trade, finance and investment which merit further consideration.

I. Overall Trends

At the beginning of the 1980s the potential of South-South trade as a means of accelerating the economic growth of developing countries,[1] if not becoming the 'engine of growth', appeared bright. The volume of trade among developing countries had reached historically record levels, having developed in a remarkable fashion in the second half of the 1970s; it was rising faster than both the expansion of world trade and the overall trade of developing countries. The industrial base, technological and export capability of a number of developing countries was changing rapidly while at the same time huge new markets had suddenly emerged as a consequence of a large shift in global purchasing power to the petroleum exporting developing countries. In addition, there were ambitious efforts to promote trade and economic exchanges at a regional and sub-regional level through the establishment of trade and payments arrangements. The expectation of South-South trade steadily increasing in import area not only seemed well-founded. It appeared a desirable objective in view of the slackening of growth in developed countries [3.1 per cent a year in the 1970s compared with 5.1 per cent in the 1960s — Lewes 1980] and the evidence of growing protectionism in developed countries, particularly in respect of labour intensive manufactured exports of developing countries [see Helleiner 1979 and 1982].

However, the expectation that South-South trade would increase as a proportion of total exports of developing countries was not fulfilled in the 1980s. In retrospect the 1980s heralded a turning point and the beginning of what appears to have been a cyclical downturn of South-South trade. In the late 1980s the trends were reversed once again. Economic exchanges among developing countries in the 1980s, however, show a complex picture. Overall trade, having reached a peak in terms of value in 1981, fell until 1986; it also declined as a proportion of world trade and total exports of developing countries. The deceleration in the rate of growth in intra-trade in terms of value in the 1980s compared with the previous decade was indeed dramatic. But a somewhat different picture emerges on the basis of volume figures which exclude the volatile price movements of primary commodities, notably fuels [see Table 1]. The expansion in trade in the 1970s was more moderate than the value figures indicate and there was a continued growth in the major segments of trade other than fuel in the 1980s, albeit slower than in the 1970s. Although changes in the base year and figures based on a succession of two or three year periods in the 1970s and 1980s give somewhat different results compared with a longer period (such as a decade) and indicate the fluctuations better, they do not alter the overall picture described above.

The world recession of the early 1980s had a damaging impact on South-South trade, but the experience of different regions in South-South trade varied very

[1] Country composition throughout relates generally to countries members of the Group of 77 in Asia, Africa and Latin America and Yugoslavia plus Hong Kong and Taiwan (Province of China).

Table 1

Trends in Exports of Developing Countries (1970-1987)

	1970	1980	1987	Change in value 1970-1980	Change in value 1980-1987	Change in volume[a] 1970-1980	Change in volume[a] 1980-1987
	$ billion			% per year		% per year	
Intra-trade of developing countries							
Food	2.2	15.5	14.8	21.6	0.6	7.4	6.5
Agricultural raw materials	1.2	5.7	5.8	16.9	0.2	3.4	2.1
Ores, minerals and metals	0.4	3.5	4.9	24.2	4.8	15.9	12.1
Manufactures	3.2	37.6	62.2	27.9	7.3	16.5	7.3
Fuels	3.8	75.0	43.0	34.8	-7.5	1.2	-0.7
TOTAL	10.8	137.3	130.7	29.0	-0.7	4.6	3.2
Exports to other countries							
Food	12.4	47.8	53.4	14.5	1.6	1.1	8.8
Agricultural raw materials	4.3	14.4	13.1	12.9	-1.3	1.8	1.8
Ores, minerals and metals	6.5	20.2	16.0	12.0	-2.7	4.8	3.5
Manufactures	6.3	62.7	186.6	25.8	16.5	14.5	16.5
Fuels	14.5	271.5	96.4	34.0	-13.5	0.7	-7.2
TOTAL	44.0	416.6	365.5	25.2	-1.8	2.0	-1.4
Intra-trade of developed countries	170.0	903.0	1359.8	18.2	5.9	5.8	4.6
Exports of developed countries to developing countries	42.7	295.0	312.2	21.3	0.8	8.6	-0.4

Source: United Nations *Monthly Bulletin of Statistics*, May 1985 and 1989; *UNCTAD Commodity Year Book 1988*

a The figures indicate the broad order of magnitude of changes. The deflators used for exports of each product group are based on market prices and not unit values and do not relate to the product mix of South-South trade exclusively; nor do they take account of quality changes. The deflators used for all totals are based on unit values; the deflators used for exports of developed countries, based on unit values, are the same irrespective of the direction of trade.

widely. Latin America as a source of exports contracted rather sharply. There was a similar downturn of exports from Africa. The economic and financial crisis faced by many countries in these two regions arising from the collapse of commodity prices, the rising cost of servicing the soaring level of external debt and the sharp contraction of the supply of commercial credit reduced their capacity to import.[2] Taken together with slow or negative economic growth the outcome was a substantial fall in the volume of imports including those from other developing countries [see Table 2]. The relationship between capacity to import and South-South trade was also reflected in the exchanges between OPEC countries and other developing countries. The imports of OPEC countries from other developing countries, which had risen from $1 bn to $23.5 bn between 1970 and 1984, fell moderately following the much lower earnings of OPEC countries in the mid-1980s.

The experience of South and South-East Asian countries was very different from that of other countries. They expanded their trade with other developing countries steadily and in 1987 and 1988 at an accelerated pace. The stimulus was primarily

[2] See UNCTAD *Trade and Development Report*, published annually since 1981.

Table 2

Volume Indices of Imports

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
				(1980 = 100)				
Latin America	109	92	76	77	76	75	73	76
Sub-Saharan Africa	116	97	85	71	75	72	71	66
(excluding fuel exporters)[a]	(96)	(88)	(93)	(83)	(86)	(91)	(95)	(90)
South and South-East Asia	113	116	123	132	127	138	164	200
Major petroleum exporters	127	125	112	103	90	75	70	72

Source: UNCTAD Handbook of International Trade and Development Statistics, 1988

[a] Angola, Congo, Gabon and Nigeria

regional trade within South-East Asia. The rate of economic growth in this region has been high particularly in Hong Kong, Taiwan (Province of China), Republic of Korea and Singapore and more recently in other countries such as Thailand, Malaysia and to a lesser extent, in the Philippines and Indonesia. There appears to be a marked trend towards greater integration and specialisation in the region. The linkages among the entrepreneurial, banking and trading communities in many countries of the region, good marketing and transport networks, substantial flows of investment capital from certain surplus countries to others where labour costs are low have all contributed to booming trade. More recently, there would also appear to be a more direct relationship between higher exports to developed countries and enlarged trade among countries of the region. Enterprises in the more industrially advanced countries where wage rates and currencies are rising, appear to be investing heavily in joint ventures in the second tier of industrialising countries where wages are lower, in order to obtain low cost supplies of components for exports of finished products to developed countries.

The overall trends in exports from developing countries in the 1980s highlight three other features. *First*, there was a clear shift in the direction of trade towards developed countries. Total exports from South and South-East Asia and Latin America were $120 bn and $12 bn higher respectively in 1987 than in 1980. Nearly three-quarters of the increase from South and South-East Asia and the entire increase from Latin America were accounted for by higher exports to developed countries. Exports to developed countries as a proportion of total exports have been increasing for most developing countries throughout the 1980s. This has been particularly so for exports of manufactures; the proportion of the total exported to developed countries rose from less than two-thirds to nearly three-quarters. The main reason was the sharper slow-down in economic growth in developing countries than in developed countries. Relatively faster growth in demand, the size of markets and their relative openness, made developed countries, particularly the United States, a strong magnet for exports from developing countries.[3] Other factors also tended to bias trade in favour of developed country destinations. One was the heavy pressure of debt service obligations which had a detrimental effect on trade with other developing countries, e.g. Latin America's exports of manufactures to developing countries as a proportion of total exports of manufactures declined from 51.4 per cent in 1980 to 28.2 per cent in 1987. High priority was attached by foreign exchange starved countries to export for payment in convertible currencies in order to service their debts and to import, as far as possible, on credit, on concessional terms or aid, including tied aid. The capacity of developing countries to extend credit was limited. Nor did developing countries find exporting to heavily indebted countries attractive because of the spread of import restrictions to conserve foreign exchange and delays in payments [UNCTAD 1985]. Consequently there was a tendency for developing countries as a whole to re-direct exports to developed countries.

A *second* feature was the slump in intra-trade of integration groupings in the 1980s. The cash flow squeeze of members of these groupings overwhelmed and rendered ineffective the mechanisms of payments support and credit arrangements of groupings. Financial difficulties and the adjustments required led to the widespead imposition of trade restrictions to reduce imports. The setback to intra-trade of

[3] The evidence suggests that in the 1970s and 1980s, while industrial protection in developed countries had become pervasive in scope and trade coverage it did not reverse the buoyancy of total imports of manufactures of developed countries from developing countries.

Table 3	Share of South-South Trade in Total Value of Exports and Imports of Individual Product Groups

	Exports		Imports	
	1980	1987	1980	1987
	(per cent)			
Food	24.5	21.7	33.2	30.0
Agricultural raw materials	29.0	30.7	43.3	38.2
Ores and metals	14.8	23.5	30.0	32.3
Manufactures	37.3	25.0	12.9	18.5
TOTAL (excluding fuel)	30.1	24.6	16.6	20.1

Source: UNCTAD Handbook of International Trade and Development Statistics 1988

Table 4	Trade of selected groupings ($ value), 1970-1987

Integration Grouping[a]	Average annual growth rate					
	Intra-trade		*Total exports*		*Total imports*	
	1970-80	*1980-87*	*1970-80*	*1980-87*	*1970-80*	*1980-87*
	(per cent per year)					
ALADI	23.1	-3.6	20.6	-1.2	21.2	-6.9
CACM	14.3	-14.7	18.1	-4.2	18.9	-3.3
CARICOM	17.1	-2.7[b]	25.9	-11.2	20.4	-11.9
ECOWAS	33.0	-12.0[b]	26.6	-9.0	26.8	-12.5
ASEAN	30.1	3.4	28.0	0.6	23.5	0.4

a ALADI: Latin American Integration Association; CACM: Central American Common Market; CARICOM: Caribbean Community; ECOWAS: Economic Community of West African States: ASEAN: Association of South-East Asian Nations.
b 1980-86

Source: UNCTAD *Handbook of International Trade and Development Statistics. 1988*

groupings was particularly severe in volume terms in the case of groupings in Latin America and Africa [see Table 4]. There was a reversal of these trends in 1987 and 1988 but levels have not reached previous peaks, except in ASEAN.

Third, the weakness of inter-regional trade became pronounced. Historically the greater part of trade among developing countries has been carried out within regions, reflecting primarily the geographical proximity of markets. Inadequate transport facilities, weak marketing networks and banking facilities and institutional barriers have also hampered inter-regional trade. In the 1970s, however, notwithstanding the constraints, inter-regional trade grew because of the increased trade flows of OPEC countries, reflecting higher volume of imports and higher prices of fuel exports. By 1980 inter-regional trade accounted for over 50 per cent of South-South trade. There has been a reversal of these trends in the 1980s partly because of the fall in fuel prices and the downturn in OPEC countries' demand but, more significantly, because the greater integration of South-East Asian

countries. Their growing dominance in South-South trade is evident in that intra-trade of South and South-East Asia rose from 21 per cent to over 36 per cent of their total exports between 1980 and 1987, and their share of total South-South trade rose from one-third to one-half in this period.

Within the overall trends there have been significant changes in the commodity composition of South-South trade. At the beginning of the 1980s when petroleum prices reached a peak, well over one-half of the market share of the South in developing country imports was attributable to fuel imports. This share had fallen to one-third by 1987, reflecting largely the fall in fuel prices. Intra-trade in food was a smaller proportion of total exports of food from developing countries in 1987 than at the beginning of the decade. In contrast, there was a shift in favour of developing countries in exports of raw materials, primarily reflecting increased demand for industrial inputs by fast-growing but resource-poor developing countries. These movements of primary commodities were overshadowed by developments in exports of manufactures from developing countries. Manufactures was by far the most important, dynamic and valuable segment of South-South non-fuel trade in the 1980s, which has implications for policy in the 1990s; and unlike other product groups its share in total imports of developing countries has risen significantly. The share of manufactures in intra-trade has been rising ever year. By 1987 it accounted for around 70 per cent of South-South non-fuel trade compared with 56 per cent in 1980; at the same time it is highly concentrated within the regions, and a major development has been the dominant position established by East Asian countries as a source of intra-trade. The change in structure was even sharper for exports to developed countries; the rate of expansion of exports of manufactures to developed countries was double the corresponding growth of intra-trade [see Table 1]. The overall result was a substantially reduced share for South-South trade in the global exports of manufactures from developing countries.

Changes in the product structure (in terms of factor intensity) of the destination of exports of manufactures are also of relevance for future policy. At the beginning of the 1980s roughly one-half of global exports of developing countries consisted of labour intensive products, with the balance almost equally divided between capital intensive and capital and skill intensive products [see Table 5]. Within these global totals the historical pattern has been greater reliance on developed country markets for the export of labour intensive products, while the bulk of intra-trade consisted of capital intensive and capital/skill intensive products. This pattern continued in the 1980s. At the same time, there appears to be a distinct rise in the share of total capital intensive products in both intra-trade as well as exports to developed countries. Intra-trade of developing countries in labour intensive products in the 1980s has risen only marginally. On the other hand, there was a surge of exports of labour intensive and capital/skill intensive products from developing to developed countries.

The number of developing countries which are becoming sizeable exporters of manufactures is increasing. By the late 1980s the number of countries exporting more than $1 bn of manufactures exceeded 20. At the same time the major exporting countries of East Asia account for an increasing proportion of the total. Currently a substantial proportion of exports from developing countries to other developing countries is attainable to four countries: Taiwan (Province of China), Republic of Korea, Hong Kong and Singapore. Their share of global exports of manufactures from developing countries is even higher than their share as a source of exports in intra-trade. Labour intensive products constitute the most important part of exports of these four countries, particularly to developed countries. A larger proportion of exports of other developing countries to both developed and developing countries consist of capital intensive products [see Table 6]. These products, however, are essentially intermediate products. Value added is greatest for capital/skill intensive products. The four countries' export trade thus exhibits a higher technological content than the exports of other developing countries.

II. Some Implications for Policy

The surge in exports of manufactures to developed countries from developing countries in the latter half of the 1980s, stimulated by joint ventures and subcontracting arrangements between firms in developing countries and those of developed countries, and the relatively sluggish expansion of intra-trade of developing countries in the same period, have given rise to a certain pessimism as to the prospects for South-South trade in the 1990s and to the emphasis to be placed on this flow of trade relative to trade with developed countries in the export strategy of developing countries. The pursuit of more market-oriented economic policies in general, and export policies in particular, has been associated with the attention of many governments of developing countries being centred on the expansion of exports to developed countries. Exchange rate policies, the industrial strategy, foreign investment, including policies towards transnational corporations, have all been adapted with this goal in mind. There is a widespread perception in many developing countries embarking on industrial development that trade relationships with developed countries are of overwhelming importance, and that the path to

Table 5

Structure of Developing Countries Exports[a]

	1980			1986		
	Developing countries	*Developed countries*	*World*[c]	*Developing countries*	*Developed countries*	*World*[c]
Destination Category of products			($ bn)			
Capital intensive[d]	11.3	12.5	25.4	14.2	19.9	38.1
Capital/skill intensive	12.7	14.9	29.2	16.6	37.0	57.8
Labour intensive[e]	15.0	37.0	54.8	16.0	64.0	86.4
TOTAL[c]	39.0	64.4	109.4	46.8	120.9	182.3

Source: GATT International Trade 1987-88; *UNSO* COMTRADE

a Includes re-exports.

b *Capital intensive products:* Iron and Steel, Chemicals, other semi-manufactures.
Capital/skill intensive products: Machinery for specialised industries, office and telecommunications equipment, road motor vehicles, other machinery and transport equipment.
Labour intensive products: Textiles, clothing, household appliances, other consumer goods.

c Includes Socialist countries of Eastern Europe and of Asia.

d Semi-manufactures include both capital and labour intensive products.

e Primarily unskilled labour intensive manufactures but household appliances include both labour intensive and capital intensive products.

maximising export growth is to seize the opportunities provided by the vast markets in developed regions. It is felt that there are scale advantages in efforts to concentrate attention on entry into the markets of the United States, EEC and Japan. Moreover, policy-makers in many developing countries are of the view that as some of the fast growing East Asian countries move up the technological ladder, diversify their production structures and export higher technology products, there would be room for a second tier of industrialising countries to replace them as exporters of labour intensive products (such as textiles and clothing) to developed countries. Fast export growth to developed countries would also, as a by-product (through higher incomes and import demand), lead to increased intra-trade of developing countries reflecting complementarities and mutual feedbacks.

An industrial strategy for the Third World which is heavily biased towards exports to developed countries can hardly be expected to meet with the success achieved by South East Asian countries in the 1990s [Cline 1982]. Although imports of manufactures from developing countries as a proportion of total consumption of manufactures in developed countries amounts to about three per cent, which suggests the potential for increase, it would not seem realistic to envisage that industrialising countries which include countries with large populations such as India, China, Indonesia and Brazil and a number of others with sizeable populations, would find markets in developed countries to sustain the export growth required to achieve their economic growth targets at levels achieved by the four East Asian countries. The reason for this is simple. A major proportion of exports from developing to developed countries consists of labour intensive products, although in recent years there has been a fast rate of growth of exports of technology intensive products from a few countries. For many unskilled labour intensive products the proportion of imports from developing countries to total consumption in developed countries is significant, e.g. over 20 per cent in clothing. Exports are bound to 'hit a buffer' sooner rather than later as the product mix of exports from developing countries is fairly narrow so far. There are consequently limits to market demand for such products. Once these are reached, competitive factors would tend to reduce prices and to worsen the barter terms of trade. Indeed, in the 1980s, unit value

Table 6

Structure of Exports of Manufactures of Four Largest Exporting Countries and Other Developing Countries, 1986

	Four countries[a]			*Others*		
Category of products[b]	*Exports to developing countries*	*Exports to developed countries*	*World*[c]	*Exports to developing countries*	*Export to developed countries*	*World*[c]
			($ bn)			
Capital intensive[d]	5.0	6.3	12.1	9.2	13.6	26.0
Capital/skill intensive	8.9	23.1	35.0	7.7	13.9	22.8
Labour intensive[d]	11.5	50.3	66.2	4.5	13.7	20.2
TOTAL	25.4	79.7	113.3	21.4	41.2	69.0

Source: GATT International Trade 1987-88; *UNSO* COMTRADE

a Taiwan (Province of China), Republic of Korea, Hong Kong, Singapore.

b *Capital intensive products:* Iron and Steel, Chemicals, other semi-manufactures.
Capital/skill intensive products: Machinery for specialised industries, office and telecommunications equipment, road motor vehicles, other machinery and transport equipment.
Labour intensive products: Textiles, clothing, household appliances, other consumer goods.

c Includes socialist countries of Eastern Europe and Asia.

d See footnote[d] and [c], Table 5.

indices of manufactured goods exports from developing countries in terms of SDRs have fallen by about 10 per cent, while those of developed countries have risen by about the same percentage. Should prices weaken as a result of the pressure of large increases of supplies from developing countries, protectionist measures[4] in developed countries, including punitive tariffs (possibly in the form of anti-dumping duties) voluntary export quotas and floor prices would inevitably proliferate against imports from the South. A growing dependence on the markets of developed countries would also not be without its price in other ways. The recent experience of East Asian countries shows the pressures that such dependence leads to, not only in respect of trade liberalisation but in relation to a wide range of issues such as liberalisation of financial markets, protection of intellectual property and an open door for foreign investment.

Developing countries, particularly those which are acquiring an industrial capability, thus face a choice as to their export strategy in the 1990s. One option is a rate of economic growth consistent with international demand determined largely by market conditions in developed countries. If this were the desired rate of economic growth there would scarcely be a need to focus attention on the direction of trade and, more specifically, on the conscious pursuit of policies to promote South-South trade. If, however, slow growth in developed countries limits desired economic expansion in developing countries, the situation is radically different. Efforts to overcome this constraint require a higher rate of increase of trade than would be achieved through the normal operation of market forces, notwithstanding the dynamism of this flow of trade towards the end of the 1980s. It is this margin or surplus (or surplus capacity) over the above what can be absorbed by developed country markets that provides the core of the case for specific measures to be adopted to expand South-South trade.

What are the prospects for the slack in exports to achieve desired growth targets being taken up by higher South-South trade expansion? It is probable that the rapid expansion of intra-trade among the developing countries of South East Asia witnessed in recent years would continue unabated, stimulated primarily through accelerated investment flows. But

[4] For an appraisal of the factors that are at the source of any acceleration or arrest of protectionism in developed countries in the 1990s, see Jean A. de Castro, 'Protectionist Pressures in the 1990s and the Coherance of North-South Trade Policies', *UNCTAD Discussion Paper* No. 27.

elsewhere in the Third World spontaneous market forces seem unlikely to give the impulses to absorb increases in output of manufactures and primary commodities which would be associated with high rates of economic growth in developing countries through South-South exchanges. In most developing countries' markets participants are in the private sector; the general trend of deregulation and privatisation of economic operations reinforces their influence on trade. The economic operators 'run the show' in the field of trade guided by the profit motive, and they cannot be expected to increase exchanges among developing countries unless the constraints to trade are removed.

The most important impediment to increased trade among developing countries relates to trade barriers. Protection is high in developing countries in comparison with developed countries, although the trend is downward[5] as a result of liberalisation associated with adjustment policies agreed with the IMF and IBRD in return for loans, and intense bilateral pressure of developed countries on some major exporters of manufactures. Its incidence on exports from developing countries has probably also lessened as the range of industrial products in which developing countries have shown an ability to compete internationally has broadened to include capital/skill intensive products. The degree of protection for these products in most developing countries tends to be less than for labour intensive manufactures.

Besides trade barriers there are a number of other constraints which act as a brake to increasing trade exchanges among developing countries. Inadequate information on markets and marketing institutions, the absence of established business and banking linkages and delays arising from the weakness of communication channels all constrain trade expansion. Inter-regional transport facilities are another area where links are not well developed and relatively costly. Likewise, financial networks inter-regionally are a problem. Trade credits often involve intermediary banks in developed countries, and transaction costs tend to be higher than in dealings with developed countries.

III. Policies for the 1990s

Trade Preferences among Developing Countries

Lowering tariff and non-tariff barriers applied by developing countries stands out as a priority area for action to provide a new momentum to South-South trade. Given the wide disparity in levels of development, industrial structures, trade and payment balances and dependence on import duties for revenue, no uniform policy on trade liberalisation, applicable to all developing countries, would be realistic, or indeed, desirable. Selective protection of industries to develop and support industrialisation is a widely adopted strategy. Some countries, however, particularly those which have mature industries, consider relaxation of import restrictions the appropriate policy orientation for them. Many countries have in fact reduced barriers on a wide range of products with a view to facilitating improvements in the efficiency and competitiveness of their export oriented industries. Several others are moving in the same direction. The advantages and drawbacks of selective protectionism versus across-the-board reduction of trade restrictions (to provide neutrality of incentives) lie outside the scope of this article. The key issue is the extent to which trade liberalisation would bring about a change in the direction of trade on the premise argued earlier that developing countries should look increasingly to each other's markets to provide the impulse for their trade and economic growth. One approach would be for a growing number of developing countries to lower barriers on imports, selectively or generally, either unilaterally or in exchange for concessions by both developed and developing countries in the ongoing Multilateral Trade Negotiations (Uruguay Round). All such reductions would be applied irrespective of source. However, while improved market access generally might have a favourable impact on market opportunities, efficiency and competitiveness in developing countries, it may have little effect on changing the direction of trade, given that developed countries supply around 80 per cent of non-fuel imports of developing countries. A more promising approach to boost South-South trade would be to complement the results of the Uruguay Round by a scheme of trade preferences among developing countries to further lower tariff and non-tariff barriers on a reciprocal basis over and above those agreed in the Uruguay Round.

A strong case could be made for trade preferences among developing countries. Preferences extended by the industrially advanced developing countries would provide an incentive to develop and nurture infant industries in less advanced developing countries until they become internationally competitive. Experience of preferences granted by developed to developing countries in the framework of the Generalised Scheme of Preferences show that trade preferences have encouraged a number of less industrially advanced developing countries, especially those with small domestic markets, to establish export oriented industries. Another advantage of trade preferences among developing countries is that its trade creating effects would tend to improve their overall terms of trade. Increased exchanges with each other, in part reflecting additional income and demand arising from

[5] See *UNCTAD Trade and Development Report* 1989 Chapter V, 'Trade Policy Reform and Export Performance in Developing Countries in the 1980s'.

output expansion stimulated by preferences, would reduce the pressure of exports to developed countries and, as a consequence, export prices would tend to be higher than they otherwise would have been.

The best modalities to move forward in respect of a preferential arrangement among developing countries as a whole would need to be fashioned in line with the broad thrust of national industrial and export policies pursued by developing countries. In this regard it seems evident that a preferential arrangement would need to be formulated in the context of the outward-oriented export policies being pursued by a number of developing countries, particularly in South and South East Asia and Latin America. Given the heavy reliance on the markets of developed countries and the importance attached to this flow of trade by developing countries, a preferential arrangement is likely to be viewed by them in the perspective of its place in achieving the objectives of outward oriented export policies rather than as a highly protective mechanism for collective import substitution. Trade preferences would consequently be looked upon as a means to enhance overall competitiveness that would promote export growth to all destinations. The orientation would be to assist closer integration and linkage with each other and the world economy. The objective sought generally by developing countries is trade creation rather than trade diversion. Collective import substitution would consequently have to be largely a by-product in a dynamic context of substantial increases of total trade of developing countries, rather than a policy pursued consciously.

With the increasing diversity in the output of industrial products, it is manufactures which offers the greatest potential to expand South-South trade through trade preferences. They could be supportive of realising more rapidly the longer term objective of most developing countries, which is the industrial transformation of their economies based, where appropriate, on domestic natural resources. South-South trade preferences offer the possibility of reciprocal reduction in trade barriers among 20 to 25 countries which are, or have the potential to become, significant exporters of manufacturers. Trade expansion among them through preferential arrangements, however, would have a beneficial spin-off effect on a wider group of countries producing raw materials or processed products. Import demand for raw materials can be expected to rise in resource-poor fast growing industrialising countries.

Trade preferences among developing countries would essentially need to be looked at as part of a broader strategy of industrial co-operation among developing countries, and one element of a package. One example of such co-operation could be between countries at different levels of industrial development. With changes in technological and production structures and wage rates, growing disparities in the capacity and capability of different countries to export certain type of goods competitively are emerging. This, in turn, provides a basis for the redeployment of labour intensive industry from high-wage to low-wage developing countries in return for improved access through trade preferences for skill intensive exports. The package for the orderly transfer of certain labour intensive lines of production between high wage and lower wage developing countries — a phenomenon which is already taking place to some extent, and had previously taken place between Japan and certain East Asian countries — could involve the flow of capital to develop production structures, possibly on a joint venture basis, technology transfer, management and marketing. The reciprocity involved if such a package included trade preferences would, on the one hand, widen the production structure of the low wage country and facilitate additional exports; on the other, it would widen market opportunities in skill intensive products. Similar arrangements could be envisaged between some of the major industrialising countries and countries rich in natural resources; processing industries in the latter associated with possible buy back arrangements could be established in exchange for improved market access for skill intensive products.

One other area where trade preferences arrangement among developing countries could potentially play an increasingly important role relates to direct trade measures including medium- and long-term contracts. The experiences of the early 1980s have shown that there are no market clearing prices under the normal operation of market forces during a deep recession. The result for many commodities was the accumulation of large surplus stocks, surplus capacity and unemployed resources in a large number of developing countries. Similarly, the absorption of additional manufactures resulting from fast rates of economic growth in developing countries might well need innovative mechanisms to promote exchanges among them. Direct trade measures including the various forms of counter-trade provide one way of handling the additional trade required for the mutual benefit of trading partners.

Developing countries in the different regions have taken the initial steps to expand their mutual trade by extending preferences to each other [Hamza 1988]. After a long process of negotiations among developing countries members of the Group of 77, the first round of trade preferences was concluded and the Agreement on the Global System of Trade Preferences among Developing Countries (GSTP) was adopted in April 1988.[6] The Agreement entered into force in April 1989. Up-to-date (December 1989) 29 of 48 countries which

[6] Proceedings of the Ministerial Meeting on the Global System of Trade Preferences among Developing Countries, Belgrade 11-13 April 1988, Volume I and II.

signed the Agreement have ratified it. The components of the GSTP Agreement include arrangements relating to tariffs, para-tariffs, non-tariff barriers, direct trade measures including medium- and long-term contracts and sectoral agreements. The preferences multilateralised to all participants in the first round of negotiations, are modest and confined to tariffs. Participation in the Agreement needs to be much larger and the preferences more broad-based for there to be a meaningful impact on South-South trade.

South-South Finance

Experience in the 1970s and 1980s has shown that the buoyancy or otherwise of South-South trade is closely related to, if not determined by, the cash flow or liquidity situation of countries. It is hard to envisage a substantial expansion of South-South trade on a stable basis in the 1990s in the framework of the GSTP as well as in a wider context in the absence of appropriate financing underpinning; fears of balance of payments problems serve to reinforce apprehensions of difficulties for domestic industries from trade liberalisation. The issue of monetary, payments and financial arrangements among developing countries is a complex one. Most developing countries do not have adequate resources at a national level to devote to the various needs of the trade sector. Still less has been their ability to subscribe to intergovernmental mechanisms which would support trade expansion among themselves. Indeed there has been no shortage of ideas and proposals on South-South finance [Avramovic 1984]. There have been extensive discussions in the 1980s relating to the idea of a South Bank [see South-South Financial Corporation 1983 and International Centre for Public Enterprises in Developing Countries, 1983] and related suggestions and other proposals for financial co-operation, such as the Third World commercial bank [South 1983] and the Latin American multinational bank [Casanova 1984]. But all these proposals foundered because of the inability to raise the necessary finance. Nonetheless the issue of finance remains central to the prospects for trade growth and has to be addressed possibly from a new starting point with less emphasis on subscriptions by governments and more on private commercial finance and international lending institutions, notably the regional development banks. In the area of finance the three major areas discussed below would seem to have priority.

An Inter-regional Trade Financial Facility

Any realistic assessment of the prospects for accelerated growth of South-South trade must take account of the constraints many developing countries face in exporting capital goods. Substantial expansion of trade flows of capital goods — an important element in a strategy of trade growth — is conditional to a greater or lesser degree on the availability of medium- and long-term credits to match the terms (often mixed commercial credit and aid) offered by developed countries. At present a number of developing countries exporting manufactures have national credit and insurance schemes. Most of them as presently operating, cannot be expected to cope with the requirements for a major expansion of exports. They are faced with two inter-linked problems. One relates to access to external funds to re-finance export credits; few can afford to postpone receipt of foreign exchange for a long period. The other relates to the cost of re-financing export credits through borrowing on the international market. As regards the former, even some of the countries with well-established national export financing schemes are under-funded from government sources and have difficulty in borrowing commercially. The problem relating to the cost of borrowing is that the lending rate for trade financing credits, which has to be competitive with that offered by developed countries, is less than the commercial borrowing rate. The margin of subsidy could be substantial, depending on the creditworthiness of the country and the terms on which it is able to borrow commercially.

As regards access to finance, the scale of resources required for capital goods exports, let alone for credits for other manufactures and short-term credits for primary commodities, makes cooperative action essential. There would appear to be no other way the needs could be satisfied. There can be little doubt that cooperative action in the form of a mutlilateral trade financing facility would be helpful to many countries, particularly those on the threshold of becoming exporters of capital goods. It would enable resources to be provided which would otherwise not have been available.

Even if there is a general acceptance of the desirability of establishing a multilateral trade financing facility, the issue of how such a facility would be capitalised would remain. As regards government subscriptions there is the experience of the 1980s mentioned earlier. A perceptible change in the positions taken in the past on this matter is still to be seen. An approach which might be a way forward as an interim measure is the sponsorship of a facility by the regional and sub-regional development banks in the context of their support for outward-oriented export development and the promotion of inter-regional trade. It is conceivable that an adequate financial base could be put together by the development banks if so minded, with the participation of private banking and financial institutions heavily involved in the trade sector. But the demand for its services might be limited in the absence of interest subsidisation. The difficulty of marrying a commercial operation with interest subsidy might be overcome if any margin of subsidy for a credit is borne by the government of the country exporting the goods. The advantage to governments of

a multilateral facility compared with the present situation is access to enlarged resources for medium- and long-term credits for their exports on finer terms than they themselves could obtain, even if it were possible for them to borrow in international markets. In addition, over time the facility might be able to build reserves which could be utilised to reduce the burden borne by governments.

An Inter-regional Clearing and Credit Arrangement

The weakness of payments and clearing arrangements at a regional and subregional level was evident in the 1980s. The mechanisms were inadequate to maintain a normal flow of trade among members of each grouping in the context of substantial and simultaneous imbalances with countries outside the region as a result of the world recession. Yet it is precisely in such circumstances that such arrangements need to work. During this recessionary period simultaneous cut-backs by individual countries, acting alone to improve their trade balances, left all countries worse off and at lower levels of economic activity — precisely the opposite of the objectives of every one of the clearing and payment arrangements. There are several reasons for the weakness of the existing arrangements. One is the limited membership of the agreements. A wider coverage of members across the regions would stand a better chance of success. There are others of a technical nature such as exchange rates, currency convertibility and possible structural surpluses and deficits which are not, in principle, insuperable.

The purpose of an inter-regional clearing agreement would be the settlement of trade related transactions. This can be expected to minimise the use of convertible currencies and reduce the foreign exchange costs of trade transactions between developing countries. Wide participation in the scheme, comprising countries of different regions, would permit a substantial share of compensated trade to be transacted. As for the balance, the settlement period could normally be for short periods to ensure the proper functioning of the scheme. The inter-regional arrangement would consequently require minimal resources from participating countries. Such a pure clearing scheme would provide a framework for the mutual creation of substantial credits all round to enable normal trade to continue in exceptional circumstances, as in the early 1980s. It would have the advantage that in normal times the scheme would function as a clearing arrangement, and in exceptional times it could function for temporary periods as a credit and payments arrangement to enable the flow of trade to continue unhampered.

A Joint Venture Investment Institution for Developing Countries

The trend towards the internationalisation of production has substantially increased the number of joint ventures established in developing countries. In the past the initiative came largely from transnational corporations, often in search of low cost supplies of components for parent companies or finished products to be exported to developed countries. The new phenomenon is the growing number of joint industrial ventures between enterprises of newly-industrialising countries and other developing countries, mainly in East Asia. The more advanced developing countries have been steadily developing the capability and capacity of offering complete packages for joint venture involving investment finance, the transfer of technology, management and assured marketing, while the less advanced countries have been offering incentives to attract foreign collaboration through joint ventures.

The current environment is thus very favourable for industrial cooperation among developing countries and the matching of partners. Cooperative action would hasten this process and help to establish joint ventures on a wider geographical basis, particularly among enterprises in different regions. A promising approach in this regard would be the establishment of a joint venture investment institution of developing countries designed to identify and prepare projects of interest to two or more partners and to mobilise finance for such projects if required. Such an institution could, in addition, act as an investment information centre, providing up-to-date information on incentives provided for joint ventures by country and by specific industry; on enterprises seeking joint venture partners; and on the banking and credit facilities on offer to promote viable joint ventures. A proposal on these lines was made in early 1982 by the Director-General of the Kuwait Fund for Arab Economic Development. It deserves to be revived and developed against the background of a more favourable environment for establishing joint ventures. It has the merit that an institution along the lines suggested could be set up with the minimum of capital and fill a gap in the institutional framework for South-South cooperation.

Conclusions

The experience of the 1980s shows the close linkage of South-South trade with the level of economic activity in developing countries, their liquidity situation, and financial and investment flows among them. The severity of the economic and financial difficulties faced by a large number of developing countries following the world recession of the early 1980s, led to a substantial reduction of trade among developing countries in value terms. Within the overall decline noteworthy features include the influence of price falls, particularly of fuels, on the value of trade; the marked divergence in trends between countries of South East Asia and other regions; the slump in intra-

trade of integration groupings; the weakness of inter-regional trade; and the greater weight of capital and capital/skill intensive products in intra-trade of developing countries in manufactures compared with their exports of manufactures to developed countries.

Against the background of developing countries' economic weakness in the 1980s relative to the 1970s, there was a peceptible shift in their trade of non-fuel exports towards the markets of developed countries. The success of some countries in increasing exports to developed countries in the 1980s in spite of relatively slow economic growth and the rising tide of protectionism and the set-back to South-South trade, has encouraged export policies of developing countries generally to be directed primarily towards the expansion of exports to developed countries.

Over-optimism as regards the ability of developed countries to absorb an increasing volume of exports from developing countries in the 1990s, particularly from newly industrialising couuntries with large populations, does not seem warranted. Developing countries need to pay greater attention to each others markets to fill the gap in export growth consistent with achieving their economic growth targets. Conscious policy measures, however, are needed to facilitate this flow of trade. The most important relate to the lowering of trade barriers. In this regard, the trade concessions negotiated in the framework of the ongoing Uruguay Round in GATT would be helpful. At the same time they need to be supplemented by trade preferences among developing countries to provide the initial boost to develop sustained expansion of South-South trade.

Trade preferences are only one instrument required to reduce the impediments hindering the expansion of South-South trade. The establishment of viable financial mechanisms are also crucial to the prospects for trade growth among developing countries. In the area of finance, an inter-regional trade financing facility, an inter-regional clearing arrangement and a joint venture investment institution merit priority consideration.

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