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GATT is not only a failure at expanding trade, but a fraud

by David Goldman, Economics Editor

At deadline Nov. 26, ministers attending the first high-level meeting in ten years of the General Organization on Trade and Tariffs (GATT) in Geneva remained sequestered in side negotiations, the plenary session having broken up in a multitude of disagreements. Despite the pious pronouncements of M. Jacques de Larosière and other leaders of international financial institutions and large commercial banks, the GATT ministers will probably produce the same dismal results that their counterparts in finance ministries produced at the annual meeting of the International Monetary Fund in Toronto in early September: general disagreement and spreading pessimism. Bankers commented after the Toronto affair that it would have been better not to have convened the meeting; next week's comments from Geneva will undoubtedly wish that proposals to cancel or postpone the meeting, which circulated in early October, had been adopted.

Worst volume since 1930s

But the great danger is that the chaos in world trading relations emerging from Geneva will obscure the fundamental issue at hand, which has nothing whatever to do with regulation of trade as such. World trade appears to be in the worst volume decline since the 1930s. International Monetary Fund officials privately concede that total world trade volume may fall 10 percent in price terms between 1981 and 1982, with virtually all of the decline registered during the second half of 1982, i.e., a 20 percent per annum rate of contraction during the second half of 1982. It remains to be seen whether industrial nations' exports recover from the immense decline during July and August, which left them a clear 20 percent below the June level. Because the summer collapse occured during a period of normally slower trade volume, the underlying impetus towards trade contraction, i.e., the unavailability of financing for deficit nations, is hard to separate out in precise terms. Nonetheless, the preliminary data suggest a fall in world trade as bad or worse than at any time since the 1930s.

It is too simple to describe the financial constraints as an exogenous problem with respect to the physical basis of trade itself. It is certainly true that the offshore money markets, the $1.8 trillion Eurodollar pool, grew during the 1970s seven times faster than international trade, and that the most immediate problems of this market cannot be fairly attributed to trade problems as such. Nonetheless it must be, and is, the case that the system characterized by the GATT and its "Bretton Woods" sister institutions, the IMF and World Bank, was flawed from the outset. The trade distortions which emerged under the IMF were of one fabric. Now this fabric has come undone, and no amount of conciliation between rival national interests will make any difference at all.

If the world is to avoid sinking back into protectionist trading blocs similar to the 1930s—a development that Soviet planners already take for granted—then the leading industrial nations, at five minutes to midnight, must come to grips with the problems that have nearly ruined the world economy.

The Third World's deficits

A crude measure of the magnitude of the distortion—crude because the IMF's statistics are biased—is given in the adjoining table, compiled from data given in the IMF's *World Economic Outlook* publication of June 1982, demonstrate that virtually the whole long-term foreign debt of the developing sector is the result of adverse 1970s terms of trade.

The nominal cumulative trade deficit of the developing nations over the decade 1973-1982 (inclusive) has been $434.5 billion. The developing nations imported in current dollars $434.5 billion more than they exported. They accumulated $505.2 billion in long-term debt to finance these imports (the small excess represents partial refinancing of interest payments on past debt), and paid $179.5 billion in interest payments on this debt over the decade. Just as interest costs must be figured into the cost of purchasing an auto or home, the interest costs derived from long-term trade financing must be added to the cash cost of imports. The adjusted deficit equals the nominal trade deficit plus the interest charges of financing the deficit: $614.0 billion.

Against this, the table compares the International Monetary Fund's "volume" index for the imports and exports of the developing nations, which is actually a compilation of national governments' estimates for the costs of their exports at fixed prices and fixed terms of trade (the relative differential between import and export prices). The "real trade balance," based on the volume rather than the nominal-price index, is cumulatively only $116.2 billion.

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That is, had the terms of trade of developing nations remained fixed over the past decade, the cumulative trade deficit of these countries would have been about one-quarter of the nominal trade deficit; in the final year in the series, 1982, the deficit would have amounted to merely 5 percent of the developing nations' imports, a negligible amount. Furthermore, the outstanding debt of the developing sector would also have been negligible.

We calculate the excess cumulative deficit of the developing nations as the difference between their nominal trade deficit adjusted for interest payments, or $614 billion, less the "real" trade deficit calculated from the volume index, or $116.2 billion.

The striking conclusion is that the total excess cumulative trade deficit of the developing nations, at $497.38 billion, is virtually identical to their total outstanding long-term foreign debt, or $505.2 billion. That is, the entire debt of the developing nations is the result of the deterioration of the terms of trade of those nations during the past decade.

Since the International Monetary Fund assembles indices of individual nations without regard for the differing bases by which the "volume" indices are calculated, it is not possible to draw the full economic conclusions evident in this comparison. Taking into account the long-term undervaluation of developing nations' non-oil raw-materials exports, especially during the past two years, the distortion in their terms of trade would be considerably greater than shown in the IMF's series. The appropriate value for raw materials exports has been a matter of intense debate for years, and the United Nations Council on Trade and Development has argued for commodity producers' agreements to raise prices, based on arbitrary formulae for export prices of developing nations. However, even the simple requirement that export prices of comodities should be adequate to generate cost plus profit in the production of those commodities would generate higher prices than those used as the base for the different national indices embodied in the IMF series. On this basis, comparable to the "parity price" conception in agriculture, the developing nations would not only be clear of debt to the industrial nations, but would be shown to pay the industrial nations a subsidy in the form of cheap exports!

That financing of developing nations' deficits has collapsed is not surprising, in the light of the above analysis: like loan-shark victims, the developing nations have borrowed the means of paying "vigerish" to the commercial banks of the industrial nations. Anticipation of the end of such means of financing accelerated the payments crisis-in-progress, in the form of an aggregate $50 billion in flight capital from the Ibero-American nations alone in the past two depression years. Mexico's credit broke as a result. The ensuing financial crisis reduced new medium-term lending to developing nations in the Eurodollar market to an annual rate of only $15 billion in September 1982, from a rate of $32 billion during the third quarter as a whole and a rate of $50 billion during the first half of 1982. This is the immediate cause of the trade collapse noted earlier.

The case of the developing sector's largest and most prominent debtor, Brazil, illustrates best the unraveling of the untenable circumstances of the past decade. Since 1979, Brazil's own terms of trade have declined 50 percent (includ-

Real versus nominal trade deficits of developing nations

(in billions of 1972 dollars)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	Total
					All non-oil-exporting nations							
Export volume	56.83	82.3	82.2	81.8	91.29	95.58	103.22	112.92	119.24	123.85	131.77	1024.17
Import volume	66.47	93.0	99.97	95.58	99.21	105.95	114.42	127.00	131.95	134.85	139.16	1141.09
Real trade balance	—	−10.7	−17.77	−13.78	−7.97	−10.37	−11.2	−14.08	−12.71	−11.0	−7.39	−116.62
Nominal trade balance in current dollars	—	−10.5	−32.8	−40.4	−25.7	−23.0	−33.0	−47.6	−70.6	−75.2	−75.5	−434.5
Excess trade deficit due to worse terms of trade	—	−0.2	15.03	26.62	17.78	12.63	21.8	33.52	57.89	64.2	68.31	317.88
Interest payments on external debt	—	4.6	5.7	7.5	8.3	10.1	14.2	20.7	30.1	37.5	40.8	179.5
Total excess deficit due to worse terms of trade	—	4.4	20.73	34.12	26.08	22.73	36.0	54.22	87.99	101.7	109.1	497.38
Total outstanding debt (cumulative)	—	96.8	120.1	146.8	181.4	221.8	276.4	324.4	375.4	436.9	505.2	—

Source: International Monetary Fund

ing the increase in interest charges), and 38.5 percent—in terms of relative export and import prices alone. That is, to make the same volume of import and related debt-service payments, Brazil must ship today twice the physical volume of goods that would have been required in 1979. During the first half of 1982 alone, exports fell by 1.4 percent in quantity but by 8.5 percent in price; and imports fell by 14.5 percent in quantity but only by 1 percent in price.

The economic depression, as Brazil's results indicate, has intensified the pressure on developing nations' terms of trade, particularly when the extremely high level of real interest rates is taken into account. Even though oil prices have fallen marginally, the combination of developing-sector currency devaluations, a 30 percent fall in commodity prices (by the IMF index) over two years, and high interest rates have ruined the trade position of the developing nations. Referring back to the table comparing nominal and "real" trade imbalances, it is striking that the difference between the nominal and the "volume" index for developing nations' trade deficits exceeded $10 billion in no year over the period 1973-1979. With the beginning of the world depression in 1980, however, the developing nations' excess trade deficit rose from less than $8 billion in 1979 to over $26 billion in 1980, over $23 billion in 1981, and an estimated $27 billion for 1982. The majority of the cumulative excess trade deficit occurred during the three depression years.

However, the growing intensity of the terms-of-trade distortion during the depression period merely underscores the nature of the problem: the industrial nations, and the United States in particular, have drawn a subsidy from the developing nations. To the extent that the U.S. economy has come under pressure, the requirements for subsidy have increased.

The United States in 1981 absorbed 42 percent of the total manufactured-goods exports of the developing nations. It also registered a trade deficit of $40 billion, and a deficit on account of industrial-goods trade. The deficit on the manufactures account, which began in 1980, represents a fundamental change; since World War I, the United States has never failed to export more manufactured goods than it imported. It also represented a fundamental change in another sense: during all previous post-World War II periods of economic recession, a drop in demand reduced imports and brought the United States into trade surplus. The bouncing-ball decline of the U.S. economy since 1980 has failed to

The U.S. approach to GATT

The November 1982 meeting of the trade ministers of the member nations of the General Agreement on Tariffs and Trade (GATT) will be the first ministerial-level meeting of GATT in close to a decade. The United States has laid out a list of objectives for the Nov. 24-27 meeting demanding not only the upgrading of protectionist measures against competitive imports, but also attacking nation's subsidizing agricultural and other production.

A statement released by the Office of the United States Trade Representative in Washington, D.C., calls completion of the negotiation of a "Safeguards Code" a top U.S. priority for the meeting. "A Safeguards Code would cover all actions that have the effect of protecting domestic producers from injury as a result of competition from imported products." The statement calls the current safeguard measures inadequate, as they apply to only about $1.7 billion in imports, while $21.7 billion worth of imports remain outside the jurisdiction of Article XIX.

The second priority of the United States is "the introduction of discipline on the use of subsidies" for agriculture. The statement calls for the freezing of current subsidy levels, followed by their phasing out over the next years. This objective is aimed directly at the price-support programs of the European Community's Common Agricultural Policy, which has enabled European agriculture to develop to the second most productive in the world. The statement goes on to call subsidies in general "a major irritant in international trade relations."

The current disputed settlement procedures of GATT, which the United States is attempting to utilize in a trade dispute over six agricultural items exported to Japan, are called "less than satisfactory from the U.S. point of view." The statement outlines two problems with the dispute settlement procedures, 1) the "lack of political will" to abide by GATT recommendations over disputes, and 2) "persistent procedural difficulties." The United States recommends greater use of the GATT Secretariat in settling disputes.

The United States is proposing a "GATT round of trade negotiations between the developed and devleoping countries . . . consisting of the developed countries offering tariff concessions on a preferential basis to all developing countries." The U.S. proposal would offer developing nations tariff rates between those of an MFN and a GSP, to converge on MFN rates over time. However, at the same time developing nations would be required to "undertake agreed liberalizations on an MFN basis."

Addressing an area of trade that has been the subject of major differences with Japan, the U.S. statement calls for a "work program on services . . . designed to achieve a broad understanding of the type of government measures that create barriers to trade in services. . . . including problems of market access and difficulties in doing business in foreign countries once access has been established."

reduce imports at all; indeed, the Commerce Department now expects a $75 billion trade deficit for 1983, and some private forecasters, e.g., the Institute for International Economics in Washington, claim that the present trend projects to an $100 billion deficit for next year.

This trade deficit—which would be more than twice as large under the terms of trade that prevailed in 1972—is the ugly secret of America's progress towards the "post-industrial society." Adjusted for terms of trade favorable to the United States, the trade deficit alone accounts for roughly one-tenth of all hard goods produced in the United States. American industry either does not have the capacity to meet demand filled by imports, or cannot meet it at sufficiently low cost to compete with imports, the result of five years of essentially unchanged industrial productivity.

Conclusions

Not only are the GATT negotiations irrelevant to the present breakdown of the world trading system, therefore, but they are fraudulent—most obviously where the American position is concerned. The U.S. administration went into the GATT meeting (see below) emphasizing adjustment procedures for unfair foreign export practices, as if the United States were the party aggrieved by unfair import competition. On the contrary: the underpricing of American imports, and the ability of the U.S. to finance purchases of foreign goods by collecting interest on debt have "financed" the Volcker measures of the past three years. The American central bank, in summary, simultaneously raised the financial cost of production inside the United States to the point of idling 20 percent of U.S. industrial capacity, while raising the cost of interest paid by America's foreign debtors, making it possible for the United States to purchase from abroad a large portion of the lost production. This is a simplification of the past three years' economic history; but this is what appears on the last line of the balance sheet.

As *EIR* documented in its Sept. 16 survey of the West German economy, the Bretton Woods-GATT System of "free trade" turns out, under close analysis, to be "fixed trade." Because the IMF, in its capacity as surrogate for American world economic leadership, has been able to fix the terms under which nations exchange their surplus product, the basic relations of world trade have been distorted by a fundamentally overvalued U.S. dollar for most of the post war period, sustained in the past three depression years by a staggering overcharge on dollar-denominated debt service.

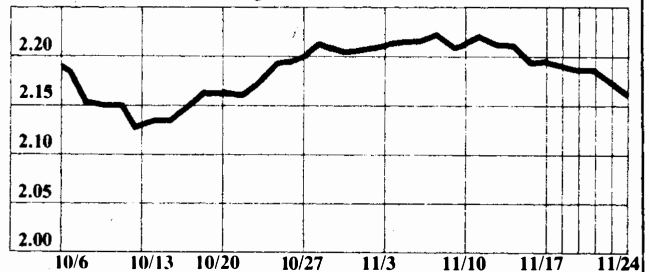
Nations will either establish agreements to finance trade in means of development at appropriate maturities and affordable interest rates—junking the GATT-Bretton Woods structure—or that structure will dissolve in a catastrophic replay of the 1930s. The GATT conference appears to have provided a negative proof that, even in the very short term, noting else will work.

Research for this article was performed by Kathy Burdman and Javier Almario.

Currency Rates

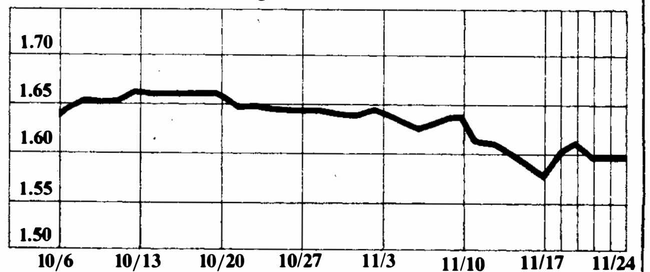
The dollar in Swiss francs

New York late afternoon fixing



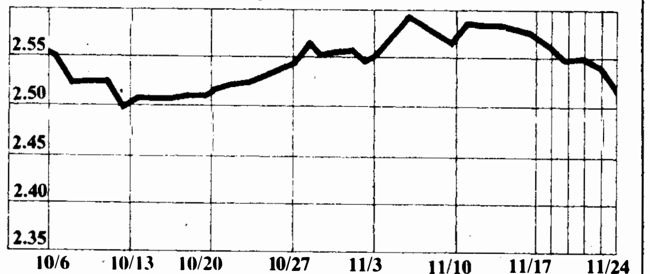
The British pound in dollars

New York late afternoon fixing



The dollar in deutschemarks

New York late afternoon fixing



The dollar in yen

New York late afternoon fixing