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THE FOREIGN-EXCHANGE GAP
OF THE
DEVELOPING COUNTRIES

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

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I. *The Setting*

History, which is a continuous process, impresses itself on human minds by discrete events. Wars, technical breakthroughs, disasters, births, and deaths are signposts of history. The United Nations Conference on Trade and Development (UNCTAD), held in Geneva from March 23 to June 16, 1964, was such a signpost.¹

Before UNCTAD began, Raúl Prebisch, its Secretary-General, stated that the purpose of the Conference was to figure out how to fill the inevitable and growing gap in the balances of payments of developing countries if they are to achieve even the modest annual income growth of 5 percent posited by the UN Development Decade. He thus hinged development to the acquisition of increased foreign-exchange resources by the developing countries. Since the Conference, not only has Dr. Prebisch continued to stress the gap theme, but he has been joined in this by spokesmen from almost every developing country in the world.

What UNCTAD did was bring to an organizational culmination the pent-up frustrations over their state of underdevelopment and their slow progress in escaping from this state of more than two-thirds of the world's nations and population. Like other discrete historical events, UNCTAD did not just come upon the world; it was built up to, and it took place when the buildup was adequate. UNCTAD did not tackle new issues; the Contracting Parties to the General Agreement on Tariffs and Trade (GATT), the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF), the Food and Agriculture Organization (FAO), other UN specialized agencies, other bodies within the UN itself such as commodity groups, the Economic and Social Council (ECOSOC), and the regional economic commissions, all had been and are dealing on a systematic basis with the issues of underdevelopment. UNCTAD

¹ *The Final Act of UNCTAD* is United Nations document E/CONF.46/L.28 of 16 June 1964. Pages 2-5 of annex B contain the joint declaration of the 77 developing countries made at the conclusion of the Conference; this declaration has become a sort of rallying document for the developing countries ever since.

was an effort to bring these other efforts into a coherent whole, to talk in one place about those famous twins, trade and aid, and to see how they and other elements could help contribute to economic growth.

UNCTAD never could have occurred if these other bodies had not done their evolutionary work since World War II. The continuing machinery that grew out of UNCTAD will not be meaningful unless these other bodies continue to make progress in their specialized fields.

UNCTAD would not have occurred in the absence of substantial previous progress in political independence and economic development. The leading countries in what is called variously the less-developed, the developing, the underdeveloped, the third, the peripheral world, are those which have reached a degree of political and economic maturity and are cognizant of the road ahead. As noted, the goal of the UN Development Decade is an annual income growth in developing countries of 5 percent. The growth rate achieved in the 1950's was 4.4 percent (in the developed countries the rate was only 4.0 percent a year),² and there is no evidence that this rate has slackened. UNCTAD, thus, did not take place in an atmosphere of stagnation in the less-developed countries.

The developed countries agreed to participate in UNCTAD and to listen to demands put almost exclusively on them. This, too, is a sign of evolution. There was no need on their part to come and listen to demands; indeed, in previous times, no one would ever have dreamed of suggesting that the developed countries should, so to speak, permit themselves to be put in the dock.

This paper will not discuss UNCTAD, or its continuing organizational machinery, but rather some of the issues which have come to a head at the present time in the thinking of less-developed countries about why their foreign-exchange earnings are impeded seriously by their trading relations with developed countries.

Some definitions may be helpful at this point. There is no accepted classification of countries as developed or less-developed, and the gray area is substantial. The GATT, in its breakdown of industrial and nonindustrial for analytical purposes, includes in the latter all of Latin America, all of Asia except Japan, and all of Africa and the Middle East. Nonindustrial thus includes Australia, New Zealand, and South Africa, and industrial includes Greece, Turkey, Yugoslavia and other European countries. GATT lists the Eastern trading area separately.

² All the statistics, unless otherwise specified, in this essay have been taken from either *World Economic Survey*, 1963, Part I (UN Document E/3908, ST/ECA/84, 1964) or *International Trade 1963* (GATT/1964-2), or both.

The UN similarly has three groups for analytical purposes: developed-market economies—North America, Western Europe, Australia, Japan, New Zealand and South Africa; the centrally-planned economies; and the developing-market economies, which make up the rest of the world.

For policy purposes—for instance, whether a country is eligible for exemption from the U.S. interest-equalization tax—it may be significant whether a country is considered developed or less-developed. For statistical purposes, the differences among the various breakdowns are not decisive, but should be kept in mind when analyzing figures.

In my own terminology, I shall use less-developed, underdeveloped, poor, and developing synonymously. I shall use nonindustrial only as GATT uses it, that is, to exclude Australia, New Zealand, and South Africa from the industrial countries.

UNCTAD was a setting, and it will be referred to as such. There are vital development issues other than increasing foreign-exchange earnings, and there are techniques other than trade for obtaining foreign exchange, but these other factors will not be dealt with except as they relate to trade as a foreign-exchange earner.

The organization of this paper will be: first, to discuss in some depth trade and related foreign-exchange issues as the less-developed countries see them; and, second, in the light of these issues, to set forth briefly the “solutions” to these problems which the less-developed countries are suggesting.

II. *Criticisms by the Less-Developed Countries*

The following are some of the elements of their trade and foreign-exchange story as spokesmen from the less-developed countries see them.

A. *Their Diminishing Share of Total World Trade*

The share of the less-developed countries in total world trade has shown a persistent decline over the past decade. Using GATT statistics, the share of the nonindustrial countries was 31.3 percent in 1953, and then almost without exception was lower each succeeding year than the year before. In 1963, the share of the nonindustrial countries was 24.0 percent. The UN statistics show the same phenomenon. The share of the developing countries in world trade declined from 32 percent in 1950 to 21 percent in 1962.

This decline has been an important reason for the general malaise of the less-developed countries over the structure and flow of world

trade since World War II. The international institutions established in the aftermath of the war to help in the smooth functioning of world trade and payments have tended to work well, but for the most part the less-developed countries consider themselves only minor beneficiaries. Between 1950 and 1962, the value of exports from the developed-market economies rose by 150 percent; from what the UN calls the centrally-planned economies, that is, the communist countries, the increase was 250 percent; from the developing countries, the increase over this time span was only 50 percent.

The countries that most needed an increase in trade enjoyed the smallest rate of increase—roughly 5 percent annually over the period 1950-1962, as compared with about 9.7 for the communist countries and 7.6 percent for the developed countries. Since the base from which the developing countries started was considerably lower than that of the developed countries, their lower rate of growth was compounded in the absolute figures for growth.

This failure of the less-developed countries to participate fully in the growth of world trade in recent years has been a major disappointment to them. It has come at a time when their emphasis on more accelerated economic growth has been greater than at any previous time in their histories. Economic growth for capital-hungry, and frequently food-deficient, countries normally requires an expansion of imports; this, in turn, requires an increase in foreign-exchange availabilities. It is this conjuncture of events—relatively poor export performance at a time when good performance was demanded—that has left the developing countries uneasy about their role in total world trade.

There are many causes for the relatively poorer performance of the less-developed countries in world trade than the performances of the communist and industrialized countries. These include: actions of the less-developed countries themselves, such as inexplicable red tape in their foreign-trade sector and overvalued exchange rates; the structure of their economies and the items they have to export, points which will be discussed in this paper; the increased production of competing commodities in developed countries; import restrictions in the world's richest countries against many of the products of the world's poorest countries. Whatever the causes, and they are many and complex, this phenomenon of a declining share has led the less-developed countries to seek changes in the structure of world trade, and in the organizations in which present world-trade policy is discussed.

This, of course, is part of the backdrop to UNCTAD, and is the stuff of which future discussions will be made in international-trade forums.

B. *Tribulations of Traders of Primary Commodities*

It may again be useful to cite some figures in order to understand the nature of the trade problem of the world's poorer countries. In 1962, the nonindustrial countries exported \$33.3 billion of goods to the world, of which \$28 billion, or about 84 percent, were primary products. (The UN figures show developing countries relying on primary products for 90 percent of their exports in 1961, and 85 percent if base metals are not counted as primary products. By primary products is meant foods, agricultural raw materials, metalliferous ores, and fuels.)

The significance of the foregoing figures is that the less-developed countries will have to rely on primary-commodity exports for the bulk of their foreign-exchange earnings for some time to come. The question of export diversification of the less-developed countries into processed and manufactured goods will be discussed subsequently; but it is worth keeping in mind that for most developing countries this diversification, no matter how successful, will not quickly replace their reliance on primary commodities. Any analysis of the trade problems of the less-developed countries must start with an analysis of primary-commodity trade.

1. *Low elasticities of demand*

Figures on elasticities of demand, both relative to the price of the product and to the income of the consumer, while not precise, are clearly indicative of some general conclusions. The major conclusion is that, for many of the key primary products exported by the less-developed countries, both price and income elasticities are low. Within a relevant price range (even though it is difficult to determine precisely what this range is), coffee consumption does not seem to be affected by price changes. Similarly, for wealthy countries like the United States and Canada and those of western Europe, further increases in incomes do not lead to any significant increase in coffee consumption.

These inelasticities do not necessarily prevail for all primary products. For example, meat and feed-grain consumption tend to rise as incomes rise. The same has been true in recent years for soybeans. Some developing countries sell these products, but these seemingly more elastic primary products are exported more by developed than by less-developed countries. Only 19 percent of the meat imported by industrial countries in 1962 came from developing countries; the same 19 percent figure applied to cereals. On the other hand, 99 percent of the coffee, 94 percent of the tea, 85 percent of the cocoa imported in 1962 by in-

dustrial countries came from developing countries, and much or all of the remainder probably was transshipped.

The point being made should not be carried too far—since less-developed countries do export such products as petroleum, iron ore, bauxite, oilseeds, etc., which are more elastic both with respect to price and income—but it tends, in general, to be true that many major primary commodities exported by less-developed countries are both price and income-inelastic. Increase in the consumption of these commodities, therefore, tends to be tied primarily to population growth. Viewed from the standpoint of the need for export earnings by the underdeveloped countries, this is a slow process.

2. *Price instability*

Superimposed on this phenomenon of relatively slow long-term growth of demand for their products is the well-known problem of price instability for primary products. It is difficult to state which is the more difficult problem, the secular problem of slow growth of demand or the short-term problem of price instability; but the combination has been a formidable one in the eyes of the less-developed countries in terms of the adverse effect on their export earnings. Viewed from the standpoint of economic development, the secular problem of slow growth in demand is probably more serious, if only because it is, in theory, administratively possible to prevent excessive short-term price fluctuations.

This is a major grievance of the less-developed countries—that price fluctuations have not been reduced sufficiently in recent years. The UN has attempted to make generalized measurements of price instability. One of their conclusions is that many of the commodities supplied solely or chiefly by the developing countries—including natural rubber, most of the fibers (particularly the nonapparel fibers), the palm products (particularly copra), and cocoa and coffee—have had the least stable price movements.

Coffee prices, for example, have fluctuated violently. Using New York market prices for Brazilian Santos 4, prices in the early 1950's moved upwards to 80-90 cents a pound (at which point coffee did prove to be price-elastic). More recently, prices were 33.18 cents in October 1962, 32.73 cents in August 1963, as high as 49.85 cents in March 1964, and at present they are in the low to mid-40's.³ Cocoa prices have shown comparable fluctuations.

³ *Coffee and the U.S. Consumer*, a pamphlet issued on April 1 by the Pan-American Coffee Bureau. Present (June) figures are from the press.

For a country projecting a development program, and counting on a particular level of foreign-exchange income from its primary-product exports, downward movements in price can be catastrophic. The problem tends to be compounded in that at the very moment a less-developed country loses income because of price declines, its external credit position also suffers and foreign loans are hard to obtain. When prices increase (as they did by an average of 5 percent in 1964 over 1963), the increased income tends to encourage overproduction.

It may be useful to cite a single figure to illustrate the importance of even small price fluctuations for a product as important as coffee. The trade has estimated that world coffee imports were about 6.4 billion pounds in 1964. A one-cent-a-pound price decline, therefore, if maintained throughout the year, would involve an income decline for all exporters taken together of about \$64 million. A 17-cent-a-pound price increase, such as occurred in the period between August 1963 and March 1964, projected over a full year, would involve extra foreign-exchange income of more than \$1 billion.

3. *Deteriorating terms of trade*

The theme heard most frequently from spokesmen for less-developed countries in recent years is that the terms of trade (the ratio of export to import prices) of the less-developed countries has shown a steady secular deterioration, and a marked deterioration in recent years.⁴ This theme of deteriorating terms of trade lends itself to exploitation. Based on a year when commodity prices were extremely high, say, during and immediately after the Korean War, the index in later years shows an exaggerated deterioration. Some spokesmen of less-developed countries have picked precisely this base and then argued that income losses due to deterioration in the terms of trade have been about equal to the foreign aid given by the richer to the poorer countries; and that foreign aid, therefore, did no more than give back to the underdeveloped countries what was taken away from them through price movements. Such aid, they argue, is therefore no more than their due.

The UN itself has abetted this type of contention by attempting to measure the effect of changes in the terms of trade on what it calls "notional export proceeds", that is, what the export proceeds in some later year would have been if an earlier year's terms of trade had remained unchanged. Argentina's average notional loss, for example,

⁴ This theme was first popularized in the 1950's. Hans Singer's article on "Distribution of Gains between Investing and Borrowing Countries," *American Economic Review* (May 1950) and Raúl Prebisch's article on "Commercial Policy in the Underdeveloped Countries," *American Economic Review* (May 1959) are key expositions of this point of view.

was estimated by the UN at \$162 million from 1954 to 1960 (1953 = 100); Australia's at \$643 million; India's gain at \$73 million; the U.S. gain at \$383 million.

The concept "terms of trade" is an intellectually satisfying, albeit statistically imprecise, one. The general anticipation, because of the elasticities cited earlier, is that prices of primary products will tend to fall over time. Similarly, the general anticipation is that prices of manufactured goods will not fall over time. In the case of agriculture, the expectation is that increases in productivity will be reflected in lower prices; in industry, the expectation is that productivity increases will be reflected in higher wages—due to labor-union pressure—and stable, if not increasing, prices. Domestically, within the United States, the parity concept for agricultural price supports is a terms-of-trade idea. Spokesmen for less-developed countries often argue that what is good within a country—to support the income of producers of primary products—should also be considered good within the world community. (Some U.S. cynics counter that it makes little sense to enlarge the chaotic U.S. agricultural program to a world scale.)

Propagandists can rig the terms-of-trade figures by base-year selection. For example, Argentina's terms of trade were 106 in 1961 with a 1958 base, but only 77 with a 1951 base; Brazil's were 76 with a 1951 base and 91 with a 1958 base; Venezuela's were 102 with a 1951 base and only 86 with a 1958 base. But, at the same time, it is also true that many key commodities, such as coffee, did show steady price declines during the 1950's, and the selection of any year during that decade as a base would show deteriorated terms of trade for a country like Brazil in 1961. There is undoubtedly some justice to the plaint of less-developed countries about deteriorating terms of trade.

Even apart from the base-year selection, the measurement has its shortcomings. The same manufactured good is not necessarily the same product a decade apart; a 1951 refrigerator, for example, is not the same as a 1961 refrigerator, and these quality changes are omitted in the terms-of-trade calculation. Lower prices do not necessarily mean poor export performance; the terms-of-trade calculation omits quantity. The aluminum industry, whose terms of trade have deteriorated sharply in recent decades, is certainly not worse off today than it was earlier when its terms of trade were higher. Using a 1950 base, India's terms of trade were 103 in 1961 and Venezuela's were 90; yet no one would argue that India's foreign-trade position was better in 1961 than Venezuela's.

The terms-of-trade issue has been discussed at some length because

it tends to be repeated parrot-like by practically all spokesmen of less-developed countries. For example, one of the findings in the Final Act of UNCTAD reads as follows: "The difficulties of developing countries were aggravated by deterioration in their terms of trade during the period 1950-62" (page 8). The years chosen were at the onset of the Korean War, when prices were at their highest, and just before prices started moving upward again for many key commodities in 1963 and 1964. "Deteriorating terms of trade" has become a key rallying cry of less-developed countries.

4. *Use of synthetics and substitutes*

It would be incomplete to analyze the difficulties of primary-commodity exporters without discussing the progress of technology. To quote from an UNCTAD document: "One of the main threats to the exchange earnings of developing countries in recent years has come from the competition of synthetics with agricultural raw materials, principally cotton, wool, jute and allied fibers, hard fibers (mainly abaca) and rubber."⁵

There is an incentive, particularly in times of shortage and high prices for natural commodities, to invest time and money in research for synthetics. On the other hand, there is little incentive on the part of the rich countries to invest money in research for alternative uses of primary products produced only in the underdeveloped countries. With the principal exception of petroleum, technology, therefore, has tended to work mainly in one direction—to reduce the scope of markets for those primary products produced in the less-developed countries. (It has not necessarily reduced the uses for primary products produced primarily in the richer countries—for instance, various uses have been found for corn.)

The FAO has noted that, using 1952 as 100, raw-cotton production in 1962 was 125; wool production was 127; production of man-made fibers was 228 and, of the last, production of noncellulosics was 835. (The noncellulosics are the polyamides such as nylon, the polyesters such as dacron, the acrylics such as orlon, and polyvinyl fibers.) The production index in 1962 was 118 for natural rubber compared with 255 for synthetic (with 1952 again as 100).

The foregoing are by no means all the synthetics which compete with natural products. Synthetic detergents can be made from a petroleum base instead of with vegetable or animal fats and oils. Plastics

⁵ "Synthetics and Their Effects on Agricultural Trade," prepared by the Food and Agriculture Organization for UNCTAD (E/CONF.46/59 of 6 March 1964), p. 1.

replace metals. Synthetics have taken a large part of the market from hides and skins in the manufacture of footwear.

In addition to synthetics, substitutes are often found for natural products produced in large part by less-developed countries. Paper napkins have taken over much of the market from cotton napkins. Paper is also used extensively instead of cotton for handkerchiefs. Paper has replaced jute in packaging.

Over and above the development of synthetics and substitutes, technology has improved to the extent that manufacturers can economize on the use of raw materials. It takes less tin to make a tin can.

A full statistical and economic analysis has not been attempted of the impact of synthetics, substitutes, and improved production techniques on the sales of basic commodities on which less-developed countries depend. All that has been attempted is to make the point that this impact has been profound. Further, this impact is irreversible, and, indeed, can be expected to proceed apace.

This impact is a major concern of the less-developed countries. Their spokesmen do not really want to stop the world, but they do talk of possible mixing regulations in developed countries to prescribe a certain minimum-percentage use of natural products. They also talk, more constructively, about research in alternative uses for some of the basic products they produce—for example, an attempt to do for coffee what has been done for petroleum in the petrochemical industry.

Too high prices for natural materials will encourage the use of substitute or synthetic materials. Too high prices for natural rubber could wipe out sales of natural rubber. Too high prices for cocoa could reduce its consumption drastically. Coffee is not infinitely price-inelastic. Less-developed countries would like higher prices for their export products, but they do recognize that there may be a limit to how high.

5. *Other impediments to exports of primary commodities*

The foregoing is by no means a complete list of factors seen by the less-developed countries as limiting their foreign-exchange earnings from exports of primary commodities.

Possibly the single factor most galling to them is the tariff and non-tariff barriers imposed against their primary products by developed countries. These barriers take various forms.

For products which may be competitive with identical or analogous production in developed countries, there are tariffs and quota restrictions. In the United States, for example, restrictions apply to such products as oils and oilseeds, sugar, lead, zinc, and petroleum. (In

general, U.S. restrictions on noncompetitive products such as coffee and cocoa are nil.)

Various European countries, notably Germany and Italy, maintain substantial fiscal taxes on tropical beverages such as coffee, tea and cocoa. For example, the combined customs and fiscal duties on coffee amount in Germany to 127 percent *ad valorem* and in Italy to 174 percent. These high taxes may have some impact on German coffee consumption, which in 1958-1960 was 3.43 kilograms per capita per year (as contrasted with 7.24 kilograms per capita in the United States). It is difficult to estimate the precise effect of these fiscal and customs duties on consumption. When seeking higher world coffee prices, coffee exporters often argue that demand for coffee is price-inelastic; if this contention is true, then high fiscal and customs duties should not seriously affect consumption.

However, the principal point made by the less-developed countries is that rich countries should not seek to gain revenue at the possible expense of earnings by less-developed countries.

The European Economic Community grants tariff preferences on such important tropical products as coffee, cocoa, and bananas to African countries associated with it. Other less-developed countries, which are thereby discriminated against, particularly those in Latin America, seek the removal of this discrimination, preferably by reducing duties on tropical products to zero.

Less-developed countries typically depend on very few primary products for the bulk of their export earnings. It is this primary-commodity-export sector that frequently supports the emerging industrial sector. By contrast, in the developed countries, price and income supports to farmers represent a form of subsidy by the industrial sector to those producing primary products. Less-developed countries argue that these price and income supports in developed countries have stimulated uneconomic production, thus taking markets away from the poor countries.

The share of less-developed countries has declined both in total world trade and in trade in primary products. Between 1955 and 1961, the share of world trade in primary products of the less-developed countries dropped from 40 to 36 percent.

C. Export of Manufactures from the Poor Countries

The less-developed countries contend that: (1) while primary products must inevitably make up the bulk of their export earnings for some time to come, there are obvious limitations to the expansion of earnings

from this trade; (2) foreign-exchange receipts from capital movements, through aid, foreign loans, or even private foreign investment, are unlikely to grow substantially, if at all, in the foreseeable future; (3) their need for foreign exchange is growing because of development programs; and, hence, (4) earnings must come through diversified exports.

In short, they argue that less-developed countries must increase their exports of processed and manufactured goods.

1. *Rules of international trade favor the rich countries*

The less-developed countries believe that the rules of the game have been rigged against them.

Their grievances are directed against the most-favored-nation concept, and against the principle of reciprocity in trade negotiations which ostensibly has been the rule until now.

As to the first, the most-favored-nation principle, it has become the goal, if not always the practice, in international trade. The opposite of the most-favored-nation concept, at least with respect to tariffs, is for countries to exchange tariff preferences. A tariff preference, of course, means that some country must be discriminated against. The most-favored-nation concept gained favor as the most equitable way of treating all trading nations. The alternative was exchanges of preferences which benefited some but harmed others.

The less-developed countries argue, however, that treating all countries equally, as is the intent of the most-favored-nation principle, is just only when all countries are in fact economically equal. Or, to use another phrase popular with spokesmen of less-developed countries, there can be no equality among unequals. In short, the less-developed countries believe that equal tariff treatment to all really means, in practice, preferred tariff treatment for the developed countries able to compete under these conditions. What the less-developed countries seek is preferred tariff treatment for themselves, that is, deliberate discrimination against the manufactured exports of the richer countries.

The case in favor of tariff preferences is based primarily on the premise that the less-developed countries need a boost for their infant industries in the export field, just as countries now provide protection against imports for domestic infant industries. The less-developed countries also argue that they could import more if they were able to export more industrial goods under a preferential system.

The second argument has to do with reciprocity. This, ostensibly, has been the rule in past international tariff negotiations. Until early

this year, the rule of reciprocity had been embodied in the General Agreement on Tariffs and Trade; the rule has since been altered in the new Part IV of the GATT now accepted *de facto* by the United States and many other GATT contracting parties. In point of fact, while reciprocity was supposedly the rule, less-developed countries rarely did give precisely equivalent tariff concessions for what they received.

From the rule of reciprocity various evil consequences are alleged to have flowed. The major one is that the most important manufactured products from less-developed countries still remain subject to high tariffs in developed countries, since the former were unable to "pay" for their reduction in past negotiations. Reciprocity also led less-developed countries to reduce their own tariffs excessively, leaving their infant industries without sufficient protection.

It may be useful to quote Raúl Prebisch on some of the foregoing points: ". . . if the peripheral countries wished to reap the benefits of a liberal tariff policy for primary imports in the industrial centres, they likewise had to make equivalent concessions in their own tariffs. This is the serious drawback of such a conception of trade policy: the failure to take into account the fact that those equivalent concessions would intensify the trend towards trade imbalance inherent in the disparity of international demand instead of helping to correct it." Prebisch's argument is that less-developed countries grant "implicit" reciprocity for tariff concessions by being able to import more when given the opportunity to export more.⁶

Some brief comments may be in order. As will be noted, it is true that tariffs tend to be high on manufactured goods with a high labor content—these are the types of products frequently produced in less-developed countries—which compete with identical goods produced domestically in developed countries. This may or may not really be a consequence of reciprocity. Nontariff restrictions also are higher on such goods, for instance, cotton textiles, and this clearly is unrelated to reciprocity.

It is not true that less-developed countries had to give excessive concessions in order to obtain liberal access to developed countries for the bulk of their primary products. The evidence of this can be found in the tariffs of both the less-developed and the developed countries. Tariffs of less-developed countries are extremely high when necessary to protect a domestic industry. They run upwards of 200 percent *ad valorem* in Latin America, for example. Tariffs of developed countries,

⁶ Raúl Prebisch, "Towards a New Trade Policy for Development," report by the Secretary General of UNCTAD, UN, 1964 (E/CONF.46/3), p. 34.

except where necessary to protect domestic production or to facilitate preferential treatment, as in the case of the EEC, are low or nil for primary products coming from less-developed countries. For example, U.S. tariffs are zero for coffee, tea, cocoa, and bananas.

The explanation for the tariff structure of developed countries must really be looked for elsewhere than in prior reciprocal tariff negotiations.

2. Unhelpful structure of tariffs in developed countries

It may be useful to examine the tariff structure in most developed countries. Whatever the reason for its existence, this structure would appear to work against the efforts of the less-developed countries to augment exports of processed and manufactured goods. The structure of tariffs in most developed countries is one of the more serious grievances of the less-developed countries.

It is typical of the tariff structure of practically every country, those now developed and those in the process of development, to have higher tariff rates on processed goods than on raw materials. Where the raw material is not produced domestically, the import duty frequently is zero.

There are a good many illustrations of this phenomenon of low or nil duties on raw materials rising as the degree of processing rises. For example, in the European Economic Community, the United Kingdom, and the United States the duty on raw cotton is zero; on yarn, the duties are 8, 8, and 14 percent, respectively; on woven fabrics, they are 17, 18, and 20 percent.

For leather goods, citing the same three importing groups in order, the tariffs are: zero in all three for raw hides and skins; 7, 13, and 10 percent for finished leather; and 16, 15, and 13 percent for leather footwear.

These illustrations could be repeated at length. Oilseeds frequently are permitted entry into developed countries at zero duty rates; vegetable oils bear duties. Iron ore bears no duty in the European Economic Community, the United Kingdom, or the United States; iron and steel products have duties.

The reason for this tariff structure is to protect domestic processing industries. The purpose behind zero duties on raw materials and higher duties on processed goods is to protect domestic labor. This structure is rooted in the history of countries; it was a key aspect of the mercantilist system. The idea of this structure is to add value domestically, not importing labor embodied in the processed product. Where a raw material is not produced domestically duties are normally nil, since

there is no domestic competitor to protect. An import duty on such a raw material would only hamper the processor in his search for export markets by increasing his production costs.

The consequence of this tariff structure is to encourage raw-material exports by less-developed countries for processing in the developed countries. This tariff structure has made it difficult for less-developed countries to add the labor and processing value themselves on products destined for export. Typically, less-developed countries export hides and skins but not leather products, cocoa but not chocolate, oilseeds but not vegetable oils. This tariff structure of developed countries has made difficult the first stages of building manufacturing or processing industries in the less-developed countries.

One other point that might be mentioned is that effective import duties—in terms of protection given to domestic industries—are often higher than the stated tariff rates, since duties are levied on the total value of imported products and not just on the value added. To illustrate: assume an imported product with a stated tariff of 10 percent, made up half of a raw material which could have entered free of duty and half of value added. The 10-percent import duty applies both to the value added and to the raw material content of the product. The effective protection in this case is not 10 percent, but actually 20 percent, that is, 10 percent on the 50 percent of value added, since the raw material is available to the domestic processor free of any duty.

This fact, too—that effective levels of protection are actually higher than stated tariff rates, where raw materials are free of duty and the processed product one degree removed from the raw material carries a duty—also tends to make it more difficult for less-developed countries to enter export markets with processed products.

One final point might be made: simple manufactured goods—typically those with a high labor content relative to total value—frequently carry higher import duties in developed countries than more sophisticated goods. The less-developed countries contend that the more sophisticated goods, those traded by developed countries, have been reduced in duty by successive tariff negotiations; the simple manufactures, those exported by less-developed countries, have been less affected by tariff negotiations under the principle of reciprocity.

Of the two main themes set forth here on tariff structures in developed countries, the first, that processed goods or simple manufactures normally carry higher duties than the raw materials, is easily demonstrable; the second, that more sophisticated goods tend to carry lower tariffs than simple goods, is less easily demonstrated.

3. Import restrictions against the poor countries' manufactures by developed countries

One other important impediment to exports of manufactured goods by less-developed countries is the import restrictions of the developed countries. This is the complaint most often heard. It obviously has some validity.

The developed countries maintain nontariff restrictions against the imports of manufactures from less-developed countries for the same reason they apply tariffs—as a protective device. The usual reason given for these import restrictions is also the same as that given for tariffs—to protect higher-cost domestic labor against competition from cheap labor in the less-developed countries and Japan and Hong Kong. (This paper will not get into the discussion of whether cheap labor actually results in cheap products.)

The point need not be labored. Nontariff import restrictions exist in developed countries on canned fish, leather, leather goods, jute manufactures, coir manufactures, sewing machines, electric motors, sporting goods, and other products of interest to less-developed countries. For the most part, these restrictions are directed more against such countries as Japan than against the less-developed countries, but this does not diminish the export problem of the less-developed countries. In this respect, the United States is far more liberal in its treatment of manufactured imports from less-developed countries than almost any other developed country. Except for cotton textiles, the United States does not impose quantitative restrictions against manufactured imports.

The most onerous of the restrictions affecting manufactured exports from less-developed countries is in the cotton-textile sector. In 1962, total exports of the nonindustrial countries were about \$33 billion, of which manufactures, so-called, were about \$5 billion (so-called, because manufactures include base metals, which made up about \$1.7 billion of the \$5 billion of total manufactured exports). The textile-sector exports were about \$1.2 billion; the textile sector made up about two-thirds of the value of finished manufactured exports from the developing areas.

It is in this major sector, in which the underdeveloped countries have made an impact in terms of manufactured exports, that the nontariff restrictions against them are most severe.

The less-developed countries, as a result of this one experience, have argued that whenever they do build an export market in the field of manufactures, the developed countries retaliate with restrictions. This has been the experience in the field of cotton textiles. It is not fair,

however, to state that this one experience would necessarily be the experience in all sectors. The textile sector was vulnerable precisely because the less-developed countries increased their exports in this one sector to the exclusion of most other sectors. If, and as, export diversification proceeds into more and more products, it may be that there will be less pressure for import restrictions by developed countries.

The present complaint of the less-developed countries is that their exports of manufactured and processed goods are meager; that these meager exports are burdened with import restrictions by the rich countries; and that these restrictions are most severe in precisely the one sector—cotton textiles—in which the poor countries have had some modest export success.

D. *Some Additional Trade-Related Problems of the Poor Countries*

The issue, of course, is not trade *per se*, but development. The role of trade in this larger picture of economic growth is as a foreign-exchange earner. There are other foreign-exchange earners, and costs, and it is to some of these that this section will turn briefly.

1. *Trade and aid: trade the senior partner*

A perspective on the roles of trade and other foreign-exchange earnings may be helpful. The trade earnings of the less-developed countries in 1963 were some \$33 billion. (For the nonindustrial countries—GATT definition—the figure would be closer to \$36 billion.) Because of the general upswing in primary-commodity prices, 1963 was a good year.

In 1963, the flow of official financial resources from the industrial countries of the Organization for Economic Cooperation and Development to the less-developed countries and multilateral agencies was \$6 billion. (It is worth noting that this was the same figure as in 1962, and even lower than the \$6.1 billion figure of 1961. In other words, this flow is not increasing but, if anything, declining.) If to this official flow are added private flows, the 1963 flow of financial resources from the rich to the poor countries was about \$8.5 billion.⁷

The foregoing figures are the major sources (omitting only the in-

⁷ The source of these figures is "The Flow of Financial Resources to Less-Developed Countries, 1956-1963," issued by the Organization for Economic Cooperation and Development (Paris, 1964), pp. 18 and 19. The flow is understated in that it omits financial flows from the communist countries to the less-developed countries. It is overstated in that it does not subtract investments made by nationals of less-developed countries in the OECD countries, which may be a substantial figure. No deductions are made either for interest payments or investment income flowing from the less to the more developed countries.

visibles, which generally are a net cost rather than net earning item) of foreign exchange to the less-developed countries. As noted, the magnitudes in 1963 were: trade, \$33 billion, and aid and private investment, \$8.5 billion. Trade earnings were about four times as large as long-term capital flows and were obviously the senior partner. This is a major reason why the less-developed countries focused on trade at UNCTAD.

There are other reasons for this focus on trade. Aid flows are not increasing. They were stagnant between 1962 and 1963, whereas the export earnings of the developing countries grew by 8 to 9 percent. Given the apparent mood of parliaments in the rich countries, the poor countries also seem to have concluded that there is more pay dirt in seeking to expand their receipts from trade than from aid. And, perhaps most important, receipts from trade are a way of earning one's own way (although the less-developed countries would not mind rigging this trade in their favor to help the process along), whereas aid is not.

Private foreign investment is a potential source of foreign exchange to the less-developed countries, but this source is encumbered by nationalistic antagonisms in many of the poorer countries, and by the general lack of desire of investors in the rich countries to undertake the risks, at the profit rates involved, inherent in investing in the less-developed countries for projects other than basic minerals. The alternative investment prospects at home or in other developed countries tend to be more attractive.

2. *The debt-service problem*

Foreign loans carry a foreign-exchange impediment—they must be paid back, and usually with interest. Debt servicing is a major foreign-exchange expense of many less-developed countries. In some cases it is an overwhelming burden. Despite its inadequacies, economists use the debt-service ratio (the proportion of foreign-exchange earnings on current account—that is, exports of goods and services—absorbed by the public-debt service—that is, interest and amortization) as a simple measuring device to get a quick picture of the debt burden. Some interesting percentages of the public debt service relative to exports in Latin America in 1962 were: 22.8 percent for Argentina, 24.2 percent for Brazil, 27.6 percent for Chile.⁸ What this means is that about one-quarter of the export earnings of these three countries in 1962 theoretically had to be used for debt-servicing purposes.

⁸ Dragoslav Avramovic, et al., *Economic Growth and External Debt* (Baltimore: The Johns Hopkins Press, 1964), p. 46.

While the foregoing ratios are higher than for most less-developed countries, it is quite clear that the debt burden has become a serious problem. According to the Agency for International Development, the present external debt of the less-developed countries is more than \$30 billion. Eight percent of the external assistance received was offset by debt service in 1955; 30 percent in 1964.

The problem has a number of potential solutions: the rich countries can give, instead of lend, money to the poor countries; the poor countries can forego certain imports, particularly those financed by short-term-supplier credits; the poor countries can export more to ease their debt-service ratios; and so forth.

E. *The Trade "Gap."*

Raúl Prebisch tried to dramatize all the considerations set forth in the foregoing pages by a single, easily understandable figure. The device he used he called the trade gap.

The gap is based on some rigid assumptions. It assumes the 5-percent-a-year growth figure accepted in the UN Decade of Development. It makes the further assumption that 5-percent-a-year income growth requires not less than 6-percent-a-year import growth; the figure of 6 percent seems to be based more on intuition than on study, but it does not seem unreasonable. What was then done was to project to 1970 the export growth that would be needed to pay for import growth of 6 percent a year.

It was then assumed, and this is a major limiting assumption, that the future would be a replica of the past. As Prebisch put it: ". . . if the factors responsible for the present trend in world trade continue, the trade gap may reach an order of magnitude of about \$20 billion by 1970 if the growth rate of 5 percent is to be achieved. This gap is potential and not real: if the means of bridging the gap are not found, the developing countries will be forced to reduce their rates of growth unless they are prepared to achieve higher rates at an excessive economic and social cost involving serious political consequences."⁹

The "gap" has now entered the vocabulary of spokesmen of the less-developed countries. Their statements often tend to ignore the rigid assumptions Prebisch made to reach his figure, and they also tend to omit all the gap-filling factors of which Prebisch himself does take account, such as capital flows. There are also, of course, tremendous differences among countries masked by global, as opposed to country-by-country, estimates of foreign-exchange needs in some relevant future.

⁹ Prebisch, *op.cit.*, p. 5.

The gap, properly qualified and understood, is not an unreasonable starting point. It has now become a shorthand way of summarizing the trade complaint of the less-developed countries. (The figure of \$20 billion a year by 1970 as the size of this gap also seems to have become part of the doctrine; the use of a precise figure of this type, given all the limiting assumptions necessary to arrive at it, does, however, seem unreasonable.)

III. *Demands of the Less-Developed Countries*

In earlier sections, the attempt was made to set forth their trade problems as the less-developed countries see them. Having tried to state the problem in their way, the "solutions" being sought by the less-developed countries flow naturally. They can be set forth fairly simply.

A. *Primary Commodities.*

The less-developed countries want better control over commodity prices. Where demand seems inelastic relative to price, for instance, for coffee and possibly for cocoa, they want higher prices. For all commodities, they want more price stability at what are called "equitable" and "remunerative" levels. They would like markets managed better: through commodity agreements, where these seem feasible, or through other arrangements such as study groups which are ready and able to call on governments to move in to take remedial action when crises threaten.

There is a world coffee agreement already in existence; the less-developed countries would like to strengthen it. There is a sugar agreement, now dormant, and there may be efforts to revive this. There is an international wheat agreement, but this is of major interest to developed countries, and efforts are in progress to see if it can be strengthened. The tin agreement is being renegotiated. A projected cocoa agreement collapsed in 1963 over the issue of price, and efforts to get the major interested countries around a negotiating table once more are being made.

The less-developed countries would like the elimination of all tariff and nontariff barriers which impede the trade and consumption of the primary products they export. They would like to see zero tariffs on these products by developed countries. Those countries whose products are now discriminated against, such as Latin American coffee, would like an end to discrimination. Zero duties in the developed countries would accomplish this.

What has been set forth above are two types of solutions, one dealing with arranging commodity trade, and the second having to do with easy access to the markets of developed countries for these commodities. The two are not necessarily incompatible approaches: a particular approach may be better adapted to certain products, or some combination of both may be required in other cases. But within these overall rubrics, or some combination of them—managing commodity trade and/or freeing it from impediments—is where the less-developed countries would like to see the world move in seeking to “solve” problems of trade in primary commodities.

Obviously the actual solution is not as easy as the verbal exposition of “solutions” would make them appear. The world does not really know the range of price elasticity of primary commodities; a 35-cents-a-pound price for cocoa might or might not do permanent damage to world cocoa consumption. In order to keep prices within any given range, say for coffee, not only do importers have to cooperate, but, far more importantly, exporters must discipline themselves. They must not exceed quotas, where these exist; they must not overproduce, lest the pressure of supply on price becomes intolerable. It is difficult to know how to deal with the growth of synthetics, which one must assume will continue.

But, even admitting all these problems, the direction in which the less-developed countries want the world to move in the field of primary commodities is clear: manage markets and free markets, letting the technique and the mix fit the conditions of the product concerned.

B. Manufactured Goods

The overall rubrics in this field are similar to those in the field of primary products: rig trade a bit in the interest of the less-developed countries, and at the same time free trade more where restrictions impinge on the poor countries' exports.

Specifically, the less-developed countries want preferred treatment for their processed and manufactured goods in the markets of developed countries. For example, assuming a tariff of 10 percent on a sewing machine in a developed country, they would like this tariff to be reduced to zero for a sewing machine coming from a less-developed country but remain at 10 percent when coming from a developed country. The less-developed countries would like this without doing anything in return themselves, that is, without reciprocity on their part.

What they would like, therefore, is an end to the most-favored-

nation principle. It is not clear whether they would like all countries defined as "less-developed" to be treated equally (that is, most-favored-nation for all less-developed countries), or whether they might like gradations among these. In general, to the extent a less-developed country has an established manufacturing sector, as has India, it tends to favor treating all less-developed countries alike; to the extent that countries have no such sector, as is true for many African countries, they tend to want some gradations in treatment, giving greater preferences to the least developed among them.

The less-developed countries would like tariff structures altered in the developed countries. As indicated, they generally want zero duties for primary products. They want much lower duties for processed goods, zero also if possible. They seek an end to upward gradations in rich-country tariffs as the degree of processing increases. They seek zero duties for manufactured goods which are produced only by less-developed countries and therefore not competitive with domestic production in the rich countries (for example, handicraft products).

The less-developed countries seek an end to nontariff barriers, particularly quotas, affecting their most promising exports.

The less-developed countries already have formally achieved the principle of nonreciprocity in tariff negotiations, so this need no longer be listed as a new desideratum.

As can be seen, the foregoing is a mix in the manufactures sector: manage trade more (preferences) and free it more (by lower tariffs and an end to non-tariff barriers). There is some incompatibility in this mix. A tariff preference is more useful to a less-developed country the higher its tariff level against exports from developed countries. Thus a general lowering of tariffs by developed countries, which is one part of the mixture, tends to conflict with the potential benefit of tariff preferences.

C. Compensatory Financing

The goal of the less-developed countries is to obtain sufficient foreign exchange for purposes of economic development. Compensatory financing is a technique for providing exchange when shortfalls occur in the trade account.

Shortfalls can be of a short-term nature, and there already is a facility available through the International Monetary Fund under which less-developed countries can borrow foreign exchange when their commodity earnings decline temporarily through no fault of their own.

Shortfalls can also be of a long-term nature. How this type of

shortfall can be compensated is now under study by the International Bank for Reconstruction and Development. The less-developed countries argue that, despite all trade measures taken, export earnings might decline through causes not of their own making. In these cases, what they seek is foreign exchange that would permit them to continue with their import programs, without building up an excessive debt burden. This is the issue of longer-term supplementary financing.

Short and long-term compensatory financing are primarily aid rather than trade issues, but as conceived by the less-developed countries, they are aid measures tied to trade fortunes—such as aid to be provided when commodity prices decline, or when there are shifts in the terms of trade, or when impediments to trade are not removed as rapidly as they should be, or when new trade impediments are created.

D. Conclusion

What the less-developed countries want, put in Prebisch's gap terminology, is that there be no gap—that their export earnings increase sufficiently for the less-developed countries individually to meet their development targets of at least 5-percent-a-year growth in income, and that if the export sector lags for some reason, other means of financing be found to compensate so that development programs will not be impaired.

The goal, to repeat, is development—of at least 5 percent a year in gross income—and it is to this end that demands are made by the less-developed countries in the trade field. (The same is true for demands, not discussed here, made in such related fields as aid and in such invisible items as shipping. It is also worth noting that the most critical aspect of development, what the less-developed countries must do for themselves, has not been discussed here.)

The demands of the less-developed countries in the field of foreign trade have become well articulated in recent years. These demands can be expected to be heard, with growing intensity, in the years to come.

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