Comment on "G-7 Economic Coordination and Developing Countries," by Richard Cooper

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It is always a pleasure to read a paper by Dick Cooper, and hence a double pleasure for me to be here today to act as a discussant on his paper on G-7 economic coordination and developing countries, especially with such a distinguished chairman – indeed my former boss at the OECD.

Economic cooperation and development is literally the *raison d'être* of the OECD, and has been an issue on which I have worked for much of my professional life, so I am particularly happy to be able to develop some remarks on the themes of Cooper's paper which is wide-ranging and stimulating. I think it is important that the interactions between policy coordination of developed countries and developing countries are given due weight, because we are indeed living in a very interdependent world and the developing countries are an important part of that world. It is interesting to note too, that there has been increasing recognition that global economic problems and global environmental problems, which is where the author ends his paper, are linked – as evident in the Rio Conference last year, in the very concept of sustainable development that we hear so much about now and in all discussions of development problems.

I would like to focus my remarks on three issues which have been taken up in the paper:

1. the characterisation of North-South relations,
2. the "believability" of the model results in the paper, and,
3. the politics of G-7 coordination and how G-7 and the OECD countries more generally should be helping the developing countries.

On the first issue, the characterisation of North-South relations, Dick Cooper has rightly raised the problem about the proper specification of the "South". While the "South" is indeed a convenient collective term for all developing countries, he is right to point out that it is a very disparate group of countries which have little in common apart from being poor relative to

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most OECD countries. I would stress even more than does Cooper the importance of not analysing linkages in a traditional North/South framework – the myth of a rich industrialised "North" exporting manufactures to a poor indebted "South" and importing primary commodities from them.

The first point I would stress is that intra-OECD trade in non-oil primary products is more than twice as large as OECD imports of such commodities from non-OECD countries. On the other hand, well over half of OECD imports from non-OECD countries are of manufactured goods. Even excluding trade with the Central and Eastern European and the dynamic Asian economies, about a third of OECD imports from non-OECD countries is of manufactured goods.

"South" countries also differ considerably in their geographical trading patterns. African countries are essentially in the EC zone, Latin American countries in the North American zone and (some) Asian countries in the Japan zone. The economic cycles in the three principal "North" zones have not been in phase and this has been reflected in divergent trade and growth patterns among "South" countries belonging to different "North" zones.

Cooper points out that "South" countries vary with respect to the level and structure of external debt. In fact, the dynamic Asian economies have virtually no debt constraints, some Latin American countries still have considerable amounts of outstanding debt owed to commercial banks, and many African countries have considerable amounts of debt owed to "official" lenders. Changes in market or policy-influenced interest rates will have different effects in each case. Furthermore, much commercial bank debt, originally incurred on LIBOR terms, has been converted to long-term paper, or into equity.

This brings me to my second issue – the extent to which we should believe the model results quoted in the paper. The implication of my comments on the false North/South dichotomy is as indicated by Cooper that models based on the traditional North/South distinction may not be very useful, and more plausible results can perhaps be obtained using a more disaggregated approach, such as the World Bank's Global Economic Model which has 144 country sub-models.

Broadly speaking results from such models indicate that the impact of fiscal tightening in developed countries on a developing country depends on where the fiscal tightening originates (US, EC, Japan), and where the developing country is located (Latin America, Africa, Asia). Some of the direct impact of a contractionary fiscal shock in developed countries on developing country export volumes is alleviated by lower short- and long-term interest rates associated with fiscal tightening. Measurement of this indirect monetary impact on developing countries associated with a fiscal shock should also be based on a more disaggregated approach. Changes in interest rates in

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developed countries impacts most heavily on Latin America and Africa, with the dynamic Asian economies being hardly affected.

I have a second set of reservations, which concerns the assumptions used for generating the model results. This relates in particular to the assumptions for the G-7 or OECD countries. Is it really likely that, through better domestic policies and/or policy coordination, they could have operated their economies at potential in the 1980s while experiencing the same interest and inflation rates as actually observed? More specifically, could the European countries and Japan really have abandoned their fiscal consolidation strategy in the 1980s and have kept interest rates unchanged at baseline levels? Frankly, I doubt it. Higher inflation, which all OECD countries had had to fight hard against from the start of the 1980s, would almost certainly have involved the need for higher interest rates – as pointed out before – with effects on developing countries which would have offset much or all of the beneficial effects of higher short-term OECD growth which fiscal laxity in the European countries and Japan might have brought about.

I won't run through all the other assumptions, but it seems to me that many of them are on what one might term the "optimistic" side. Cooper has been brave in putting numbers down and giving his estimate of 5 per cent higher developing country exports in the period 1981-87 arising from stronger OECD growth, but I would suggest that this must be the absolute maximum. I strongly believe that, in this sort of replay of history, interest rates would have had to be much higher and the external conditions facing the developing countries rather worse than Cooper suggest. To be fair, he admits that the calculation is a partial analysis, that the right models do not exist, and that relaxing the assumptions would reduce the estimate. It is just that my choice of assumptions would have been less favourable to the developing countries in the first place.

Let me now turn to the third issue I would like to address, concerning the politics of G-7 coordination. Let me start with a general point. I believe the best thing that the G-7 can do for the rest of the world is to aim for a reasonable level of stable, sustained growth with low inflation. Let me stress stable and sustained. What is bad for the "South" is lack of stability in the "North", giving rise to volatility in activity, prices – especially commodity prices – and interest rates. Having higher short-term OECD growth is of little benefit to non-OECD countries if it ends in tears, as has typically happened in the past, with inflation turning up, the need for restrictive policies, higher interest rates and lower market growth.

Cooper's paper also raises the general issue of what we mean by "policy coordination" and under what conditions it is likely to succeed. In virtually all spheres of economic policy, there is some degree of policy coordination in the sense that Governments, in framing their own policies, take account of

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each other's actions and experiences. International organisations such as the OECD contribute in an important way to this process by providing Governments with a forum for the ongoing exchange of information – information about the economic context in which policy choices must be made by governments, about each other's assessment of that context, and about the actual policies adopted. As a result, contemporary governments, unlike their counterparts fifty years ago, do not take decisions largely in ignorance of what other governments are doing or intending to do. Rather, they tend to share a fairly common view of the international economic climate, and set their expectations about policy outcomes on the basis of reasonable knowledge of the goals and intentions of their peers.

But the term "policy coordination" as used in the paper goes well beyond this largely informal process of adaptation. Rather, it has strong connotations of concertation and cooperation; that is, of collective action aimed at common ends. There are, simplifying somewhat, two major ways in which this may occur, each suited to rather different circumstances.

The first is a commitment to common rules: to an agreed way of acting in specified circumstances. The multilateral trading system has been the outstanding example of such an agreement, embodied most importantly in the GATT. These rules are in the nature of a contract; and like other contracts, they are most likely to succeed when they reflect shared norms and a common understanding of the relation between means and ends. Their stability depends on the willingness of Governments to maintain commitment in the face of evolving circumstances: to not seek, in other words, to re-write the contract each time changes occur in the context for its implementation.

Secondly and in contrast, Governments may retain their discretion to act but seek to exercise it jointly: to meet changing circumstances not through the adherence to pre-established rules of conduct but rather through a process leading to concerted intervention. Such a discretionary approach has underpinned the search for agreement in the G-7.

Rules and discretion each have merits. A rule-based system gives greater predictability and is less vulnerable to the abuse of changing bargaining power: the currently strong are less well placed to exploit the currently weak. But discretion can allow greater adaptation to shifting circumstances, and can thereby avoid the types of costs which inflexible rules - for example about exchange rates – may impose.

What is an open issue is how relevant either of these approaches is to the current conduct of macroeconomic policy. Few would believe that in the current environment there is much scope for imposing fixed common rules on macroeconomic operation in the G-7. But even the options for the joint exercise of discretion by the G-7 may be severely limited. Each government

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may not know enough about where its economy actually stands in the conjuncture; it may not be able to predict with sufficient accuracy how the policies adopted will act, or how quickly their effects will be felt; and hence it may not be able or willing to forego the continued responsiveness to unforseen local circumstances. What counts under these conditions is that governments and central banks should jointly intensify that informal process of adaptation. This is exactly what the OECD Working Party No. 3 consisting of senior Treasury officials and central bankers of North America, Japan and several European countries intends to achieve at its quarterly meetings in Paris.

As regards trade policy, it is important that OECD markets are kept open to exports from developing countries, especially for manufactured goods. As Cooper notes, it is particularly disturbing that what he calls "procedural protection", such as anti-dumping suits, became common in the 1980s and seem to have been on the rise. Although developing countries have increased their shares of OECD imports of manufactured goods, further opening indeed needs to occur. But unfortunately protectionist pressures have been on the rise - despite all the fine words about completion of the Uruguay Round – and alarming sounds are being heard in OECD countries partly, of course, because of recession and the high unemployment being experienced. At the OECD Ministerial Meeting in early June, Ministers agreed to make full use of the GATT system and of the more informal mechanisms and broad expertise available in the OECD, so as to contribute to a reduction of international trade tensions and to the efficient operation of the multilateral trading system. In this context, the OECD is now working on new issues arising at the interface of trade policy and other national policies; for example the OECD Trade Committee and the Committee on Competition Law and Policy are discussing competition issues relevant in a trade perspective, such as export and import cartels, anti-dumping, vertical restraints, international mergers and other areas. The question of the desirability and feasibility of integrating competition rules into a multilateral framework will be explored.

Let me now turn to international resource flows. Cooper discusses the decline in private net capital flows in real terms and gives information on foreign direct investment, export credits and foreign aid flows. Apart from the obvious point that the "quality" of the use of these resource flows is important – they should be in uses with a satisfactory rate of return and be used to improve longer-term output prospects – I have some concern about the aggregate amount of resources available. The admittedly-imperfect figures on global and regional savings and investment seem to show that first, global savings ratios are now lower than they were in the 1960s or 1970s, and second, that the excess of savings over investment in OECD countries that characterised much of the post-war period seems to have disappeared.

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In other words the net capital flows from the North to the South seem to a certain extent to have dried up and the more mature economies are absorbing non-OECD savings to finance budget deficits and the deficiency of national savings. This is a worrying tendency. Cooper is right to call for better coordination of G-7 policies to address these issues and he is also right to point out the achievements of the multilateral financial institutions such as the IMF and the World Bank and its affiliates in organising and disbursing resources to the developing countries, as well as organising debt rescheduling and relief. Ultimately, however, I think it is necessary for the OECD countries to ensure that they get their fiscal positions right, and to coordinate their macroeconomic policies as they do this so as to avoid undershooting or overshooting and hence provide a more stable international environment. In doing this, and in ensuring that their markets are open, they do the best service to the developing countries and to global welfare.

Before closing, let me say how pleased I am that Dick has raised the issue of cooperation on global environmental problems. Such cooperation is necessary, is very important for the future of all our economies, and I am pleased to say is an area where we are doing much work at OECD in supporting the various international initiatives to deal with the problems and promote sustainable development. At their meeting in early June this year OECD Ministers asked the OECD to pursue its follow up to United Nations Conference on Environment and Development (UNCED), and in this regard to consider the feasibility of analysing the relationship between consumption and production patterns and sustainable development.

Finally, I must add that the OECD is broadening and deepening dialogue with the different groups of non-Member countries (Central and Eastern European countries, Newly Independent States of the former Soviet Union, and Dynamic non-Member Economies of Asia and Latin America) in an effort to bring about the successful integration of these economies into a multilateral system.

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