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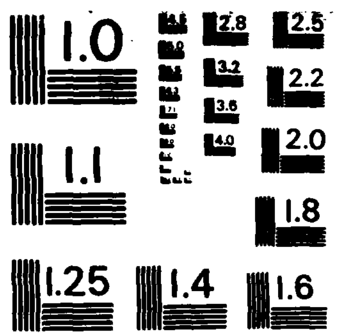

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THE INTERNATIONAL ECONOMY: FUNCTIONS AND ORGANIZATIONS

CAPTAIN KENNETH O. MORSE

DEPARTMENT OF ECONOMICS

AD A139686

FEBRUARY 1984

FINAL REPORT

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DEAN OF THE FACULTY
UNITED STATES AIR FORCE ACADEMY
COLORADO SPRINGS, CO 80840

Editorial Review by Captain Mark D. Slown
Department of English
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Colorado Springs, CO 80840

This research report is presented as a competent treatment of the subject, worthy of publication. The United States Air Force Academy vouches for the quality of the research, without necessarily endorsing the opinions and conclusions of the author.

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Thomas E McCann

THOMAS E. McCANN, Lt Colonel, USAF
Director of Research, Studies,
and Analysis

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The main purpose of this report is to identify those organizations which facilitate trade and development in the international economy, and to discuss the current integration of these organizations into the overall international economy. The identification process results in a description of the international economy, emphasizing the current integration of institutions and functions. This report considers the influence of major organizations such as the International Monetary Fund, the World Bank Group, the Organization for Economic Cooperation and Development, and the various United Nations programs on both economic development and international finance. Additionally, the influences of the General Agreements on tariffs and trade, the United Nations Conference on Trade and Development, and various regional cooperative organizations are linked to the trade and development functions. The result of charting these various influences is a composite organizational diagram which graphically depicts these interrelationships. Further, some analysis of the dynamic nature of this "system" is provided.

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THE INTERNATIONAL ECONOMY:

FUNCTIONS AND ORGANIZATIONS

BY

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FEBRUARY 1984

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PREFACE

This report began as an attempt to create a handout for undergraduate students in international economics. However, as I began to research the existing relationships in the international economy, I found that there was no single reference that identified the economic organizations functioning in the international arena.

This report identifies the major international economic institutions which exist today and links them to their specific international economic functions. Through the use of a composite diagram, each institution is added until the entire system is constructed into an integrated whole. In some instances, certain historical discriptions have been included to elaborate the dynamic nature of the current system. Thus, I have laid a basic foundation for further study and analysis of other, subordinate economic institutions.

To some extent, this distinction is arbitrary. Economic decisions in the international arena are not made in a vacuum, but are subject to extensive outside pressure. However, to insure clarity of presentation, I have purposely left out many of those influences. For those interested in further examination of these pressures and influences, two excellent sources exist. Charles H. Lindblom discusses the interrelationship between political and economic decisions in Politics and Markets (Basic Books, New York, 1977). Harold K. Jacobson has done extensive work on the political and economic relationships of international governmental organizations (IGO's) in his Networks and Interdependence: International Organizations and the Global Political System (Alfred Knopf, Publishers, New York, 1981).

In creating this schematic diagram, I had some critical assistance. Dr. Bernard Abrahamsson of the University of Denver's Graduate School of International Studies (GSIS) was instrumental in helping to identify specific links between functions and organizations, as well as providing critical comments on an early draft of this report. Also, Dr. Donald E. Parker and Dr. E. Thomas Rowe of the GSIS provided many useful suggestions for improvement.

LIST OF ABBREVIATIONS

ACP Gp	African, Caribbean and Pacific Group
ADB	African Development Bank
ASEAN	Association of Southeast Asian Nations
BF	Banque de France (Central Bank of France)
BOE	Bank of England (Central Bank of the United Kingdom)
CABEI	Central American Bank of Economic Integration
CACEU	Central African Customs and Economic Union
CARICOM	Caribbean Community
CARIFTA	Caribbean Free Trade Area
CDB	Caribbean Development Bank
CECLA	Latin American Economic Commission (translated from Spanish)
CEEC	Convention for European Economic Cooperation
CFF	Compensatory Financing Facility
CMEA	Council for Mutual Economic Assistance (COMECON)
COMECON	Communist Economic Bloc (CMEA)
DAC	Development Assistance Committee
DBA	Asian Development Bank
DBB	Duetsche Bundesbank (Central Bank of Federal Republic of Germany)
EACM	East African Common Market
EADB	East African Development Bank
ECA	Economic Council for Africa
ECE	Economic Council for Europe
ECLA	Economic Council for Latin America
ECSC	European Coal and Steel Community
ECOSOC	United Nations Economic and Social Council
EDRC	Economic Development and Review Council (OECD)
EEC	European Economic Community
EFF	Extended Financing Facility
EMS	European Monetary System
EPC	Economic Policy Council (OECD)
EPU	European Payments Union
ESCAP	Economic Council for Asia and the Pacific
FRB	Federal Reserve Board (also referred to as Federal Reserve Bank)
FRG	Federal Republic of Germany (West Germany)
GA	General Assembly (of the United Nations)
GATT	General Agreements on Tariffs and Trade
GSP	General Scheme of Preferences (UNCTAD)
IADB	Inter-American Development Bank
IBEC	International Bank for Economic Cooperation

IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Islamic Development Bank
IEA	International Energy Agency
IFC	International Finance Corporation
IGO	International Governmental Organization
IIB	International Investment Bank
IMF	International Monetary Fund
ITO	International Trade Organization
LAES	Latin American Economic System
LAFTA	Latin American Free Trade Association
LDC	Less Developed Countries
NBS	National Bank of Switzerland
NIEO	New International Economic Order
OAS	Organization of American States
OAU	Organization for African Unity
ODA	Official Development Assistance
OEEC	Organization for European Economic Cooperation
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
UK	United Kingdom (Great Britain)
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WACM	West African Common Market
WADB	West African Development Bank

I <u>INTRODUCTION</u>

The main purpose of this paper is to identify those organizations which facilitate trade and development in the international economy, and to discuss the current integration of these organizations into the overall international economy. The identification process will result in a description of the international economy, emphasizing the current integration of institutions and functions.

The world economy exists because it is advantageous for countries to trade goods and services between each other.[1] This trade requires a means of payment for these goods and services, and a means of clearing and settling trade accounts.[2] Trade is advantageous to poor countries as well as rich countries. There is an intense worldwide interest in the "development" of poor countries into rich countries through international trade and resource transfer accounts.[3] Therefore, identifying specific functions is essential to be able to describe institutional arrangements.

II <u>FUNCTIONS</u>

Organizations are created in response to functional requirements. Therefore, before looking at the various international organizations in existence, those functions will be identified. As mentioned earlier, the international economy exists to facilitate the trading of goods and services, the financing of this trade, and the development of poor countries into richer countries.

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1 The basic theory of international trade is the theory of comparative advantage, and is contained in every intermediate international economics textbook. For example, Peter H. Lindert and Charles P. Kindleberger, <u>International Economics</u>, 7th ed., Homewood, IL: Richard D. Irwin, Inc., 1982, pp. 17-57.

2 <u>Ibid</u>, pp. 243-300.

3 <u>Ibid</u>, pp. 58-109, 301-338.

Trade is the exchange of goods and/or services between two or more countries. This exchange results in more goods available than would be produced domestically, therefore individual welfare in each trading society will increase through trade. Yet, for various reasons, trade is restricted between various countries,[4] reducing total world-wide economic welfare. Thus, one function of the international economy exists is to induce countries to trade, and to limit various restrictions on trade.

Trade has, in the past, taken place on a barter basis. However, with the growth and sophistication of national economies and the growth in world trade volume, money exchanges have taken the place of barter arrangements. The use of money has led to the need for the exchange of one currency for another, which resulted in the growth of foreign exchange markets. Further, an institutional arrangement to facilitate the clearing of international accounts and the transfer of these funds became necessary, leading to the development of an international financing function.

With the rise of trade and a complementary financing system, countries identified their relative position in the world. This identification led to the realization that some countries are "better off" than others, while other countries are "worse off". Naturally, those "worse off" desire to become as prosperous and have as high a living standard as those "better off", which lead to the need to "develop" national economies.[5] However, determining "how to develop" and what the necessary

4 Most justifications for trade restrictions rest on non-economic arguements rather than economic justifications, although they are most often couched in economic terms to make them appear more plausible. Ibid. pp. 134-176.

5 Development is usually taken to mean economic growth (in total monetary value of output) as well as structural change (improved efficiency, distribution, etc). It is sufficient for this note to accept this general definition.

national and international institutional arrangements are to assure this "development" have been slow to evolve. Yet there exists a series of institutional arrangements with the stated intent to "facilitate" economic development.[6] These institutions are one of the focul points to be discussed.

Thus, the international economy revolves around three separate, but interrelated functions: trade, finance, and development. Figure 1 shows the relationship between these functions. While each function is enclosed in its own circle to indicate its individuality, all three are further enclosed in an oval to indicate this interrelatedness. Once these functions have been identified, it is time to look at the supporting institutional arrangements to facilitate these functions in the international system.

III TRADE INSTITUTIONS

There is only a single organization in the international arena whose sole concern is international trade. That organization is the General Agreements on Tariffs and Trade.

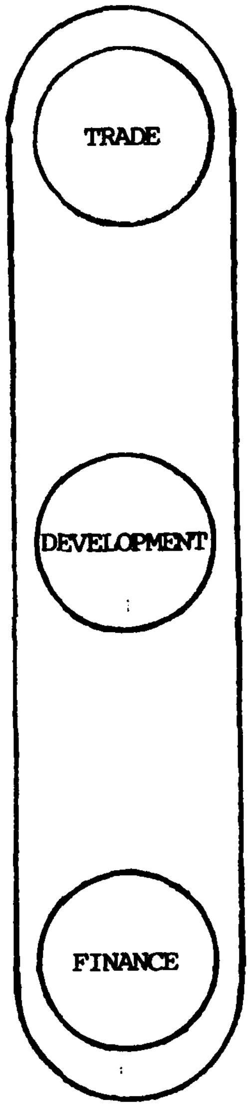
General Agreements on Tariffs and Trade (GATT)

The General Agreements on Tariffs and Trade (GATT), has been around since 1947. This "institution" is the result of two separate events. Initially, during the period between World War I (1918) and World War II (1939), significant problems in world trade arose as a result of protectionist feelings in the various trading countries.[7] As a result, at the

6 This sets aside any other form of development (political, social, cultural) as external to this institutional arrangement, as a basic assumption.

7 Specifically, the United States and Western Europe.

FIGURE 1. International Economic Functions



close of World War II, in the process of designing the post-war institutions to address these restrictions, the International Trade Organization (ITO) was proposed as a part of the newly formed United Nations. The basic intention of the ITO was to provide some method to enforce freer trade between nations. Enforcement required some penalty or sanction provision, which placed limits on individual nation sovereignty when dealing with other sovereign nations. As a result, the ITO was not approved by the major trading nations,[8] although the proposal was circulated for four years. In the interim, no institution existed to address protectionism and the limitations placed on free trade.

Therefore, as an interim measure, the major trading countries got together in Geneva, Switzerland and agreed to "discuss" and "agree" on ways to reintegrate international trade into domestic economies after the damage of the war. These general agreements had no force of law and were not formalized under any treaty provisions. These major trading countries thought at the time that the ITO would be approved in short order, and would replace the GATT format, thus forcing freer international exchange of goods and services. The original ITO proposals and their modifications remain in the proposal stage.[9]

GATT has been characterized as a "pragmatic" response to an unforseen flaw in post-war arrangements. It remains a viable international institution today, although originally a "temporary" response to changing post-war conditions. The GATT is an open forum for the discussion of

8 The major cause for failure of the ITO proposal was U. S. domestic pressure. However, similar forces existing within the Western European countries were also a contribution. Minchuan, Ku. ed., A Comprehensive Handbook of the United Nations, New York, NY: Monarch Press, 1978, p. 478.

9 The ITO remains a proposal today, under the auspices of the United Nations. However, since nations continue to be unwilling to abrogate their national sovereignty, it remains only a proposal, with little prospect for ratification.

trade related issues and the negotiation of mutual reductions for the benefit of all negotiating parties.

GATT is linked to the "trade" function of the international economy (Figure 2). The "box" shape indicates a specific institution, while the circles and oval continue to indicate the functions of the international economic system.

IV FINANCE INSTITUTIONS

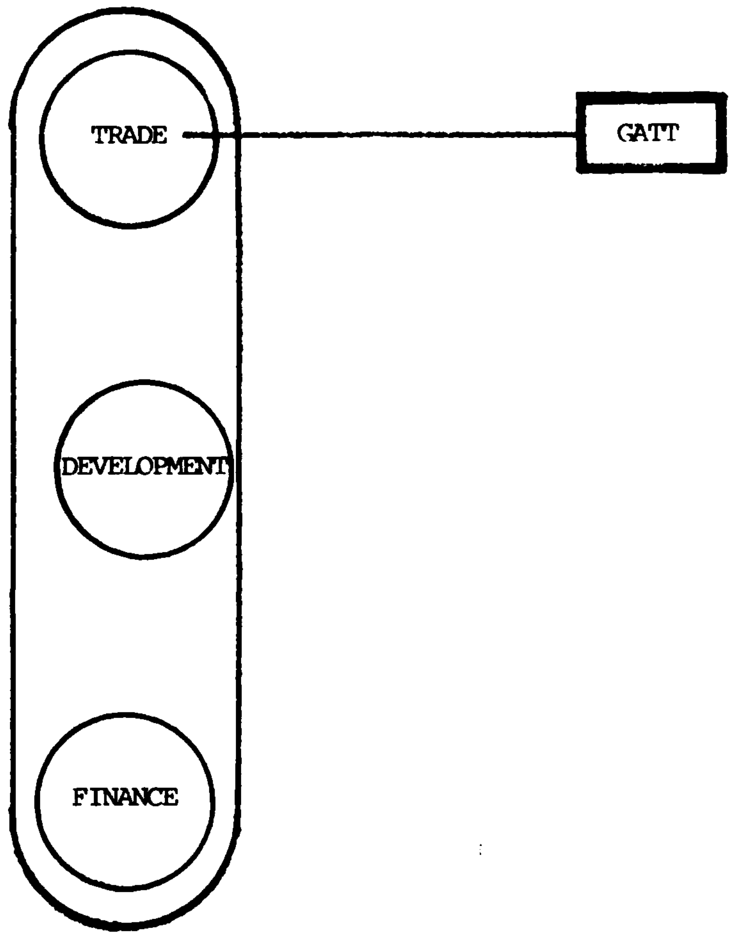
In contrast to the trade function, there are two institutions which function solely in relation to the financing of international trade. First, the International Monetary Fund (IMF) is a formally constituted organization for the monitoring and managing of international trade and exchange. The second, the Bank for International Settlements (BIS) is a private organization, whose function is advisory and consultative in nature rather than formal and official. These institutions will be examined in turn.

International Monetary Fund (IMF)

The International Monetary Fund (IMF) is one of the most powerful international economic institutions in existence. It, too, was an outgrowth of the post-war negotiations for improvements in the integration of the various industrial economies. Initially established as a result of the Bretton Woods accords of 1946,[10] the fund was charged with the responsibility of maintaining surveillance on the balance of payments positions of member countries, and of using the fixed-exchange rate

10 For a more detailed discussion of the historical development of the IMF, see Alasdair I. MacBean and Nicholas Snowden, International Institutions in Trade and Finance, London, U.K.: George, Allen & Unwin, Ltd., 1981, pp. 68-80.

FIGURE 2. Trade-related Institutions



mechanism as a tool for changing balance of payment disequilibria.[11]

The initial functional objectives of the fund were as follows. Trade between countries was to be financed through payment in one of the country's local currency. In the case of those countries which were in balance of payments deficit, some mechanism was necessary to insure deficits could be financed. Countries initially contributed to the reserves of the fund, and were allowed at later dates to apply for temporary loans to cover deficits. These covering loans were dependent on the size of a nation's initial contributions. Contributions in gold were to be followed by contributions in the national currency; both contributions would then indicate the borrowing limitations of a particular deficit country. To borrow against these funds, the deficit country had to make changes in its domestic economy. It had to submit to the IMF suggestions for improvement of "fundamental disequilibrium" conditions.[12]

A major change in international monetary management occurred on August 15, 1971. On that date, President Richard Nixon announced his "New Economic Policy" (NEP).[13] A major feature of this policy was the suspension of convertability of the U. S. dollar for gold in the

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11 For a detailed discussion of the technical methods of balance of payments adjustment under fixed-exchange rate systems, see Lindert and Kindleberger, Op. Cit., pp. 263-300, 353-363.

12 A "fundamental disequilibrium" condition has yet to be adequately defined. Under a fixed exchange rate system, this could be indicated by consistent balance of payments deficits, resulting in the continuous transfer of international reserves from the deficit country to other countries, or resulting in a devaluation of the fixed exchange rate of the national currency. Switching to a floating exchange rate regime, however, such "fundamental disequilibria", and their commensurate adjustment mechanisms are more difficult to identify and correct, since in theory deficits and surplusses are eliminated by the "floating" exchange rate.

13 Joan Edelman Spero, The Politics of International Economic Relations, 2nd ed., New York, NY: St. Martin's Press, 1981, pp. 51-52.

international exchange market. This removed one of the major balancing mechanisms from the international market, and led to a change in the means of determining international exchange rates. Since currencies could no longer be denominated in terms of their gold value, currencies were allowed to "float" to determine their international price. The result was a change to a flexible exchange rate system in the international exchange market.

With this change from a fixed to a floating exchange rate system in the 1970's, the role of the IMF has changed. In an effort to help countries address balance of payments difficulties, especially for those countries that are either single commodity economies or are tied to primary products, several "facilities" have been created.[14] These "facilities" are nothing more than special lending accounts, which are available for specific purposes over and above the normal credit financing available from the basic IMF itself. These "facilities" provide an expanded lending capability for the IMF, especially in relation to the developing countries of the world.[15]

14 The following "facilities" have been created: (1963) Compensatory Financing Facility (CFF) - to provide short-term credit for balance of payments deficits due to fluctuating world "primary" product prices; (1973) Extended Fund Facility (EFF) - to provide longer term (7 years rather than 3 years) financing for LDC's borrowing to cover balance of payments deficits; (1974) Oil Facility - to provide short-term loans to non-oil producing countries to offset effects of oil price increases; (1977) Witeveen Facility - to recycle oil surplus revenues from the oil exporting countries to oil importing countries at market interest rates. (Replaced the functions of the Oil Facility, which was allowed to lapse in 1977.)

15 The expansion of IMF lending into longer term issues for "development" purposes draws it closer to the functions of the World Bank Group (see page 17ff). With changes in the international economy as a result of the shift to floating exchange rates, this may represent a search by the IMF for a new, expanded lending role in the future. Anthony Rowley and Richard Nations, "IMF: More cash needed for the sudden transition to first resort lender" in Far Eastern Economic Review, September 29, 1983, pp. 85-87.

Bank for International Settlements (BIS)

The Bank for International Settlements (BIS) is not, formally, an institution of the international economy. However, its informal influence over the policies of individual members of the international economic community is formidable, and it therefore belongs in any discussion of international financial institutions.

The BIS was established in Geneva, Switzerland at the close of the First World War. At that time, it was instituted to establish the handling and clearing of German post-war reparations payments to the victorious allies. In this function, it provided a settlement mechanism for the transfer of funds between European countries.

After World War II, the BIS became the clearance mechanism between the European countries in their effort to reconstruct the European economy. It was the formal institution for the European Payments Union (EPU), the agreement by which the post-war European economy conducted balance of payments adjudication during the period of trade growth and rebuilding. As such, it has formally functioned as a quasi-official clearinghouse during the 1940's and 1950's.

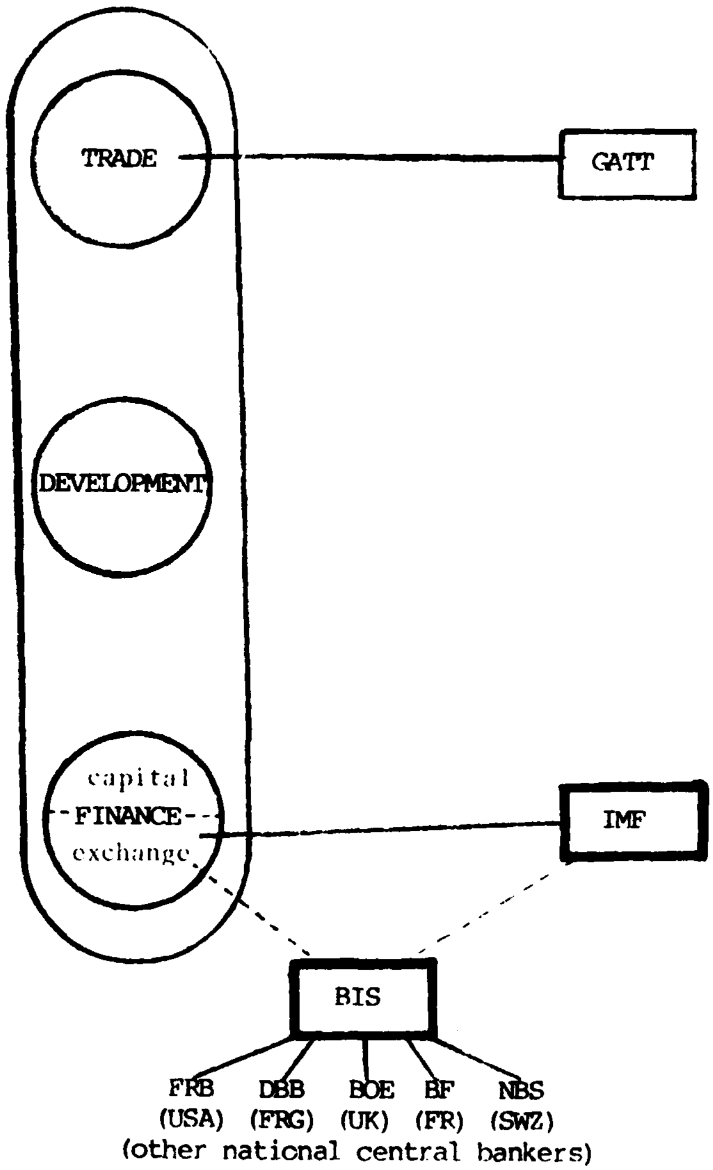
However, its role as a clearing mechanism was reduced in the 1960's as a result of the establishment of the Organization for Economic Cooperation and Development (OECD). The current role of the BIS is no longer the formal transfer of funds. It has now become primarily an organization for the discussion between central bankers of economic policy - a manager of international banking information.

The BIS is a privately held and managed institution. It functions as any other private bank would, and is managed by private concerns with special interests in the operation of the international economy. With the establishment of the International Monetary Fund (IMF) at the close of World War II, some of the functions performed by the BIS in the interwar period were formally transferred to the IMF. As a result, today the BIS serves as a private policy coordinating board for various national central bankers. The various heads of national banks (the U. S. Federal Reserve Board, the Bank of England, the Deutsche Bundesbank, and the Banque de France, to mention a few) meet periodically under the auspices of the BIS to discuss policies and plans for the international economy in an open forum. In such an atmosphere, there is little "outside" pressure for results, as the neutral site of the BIS provides an atmosphere conducive to thoughtful and freewheeling discussions.

Figure 3 indicates the role in the international financial arena of both the IMF and the BIS. The IMF is directly connected to the international finance function; specifically, the international short term exchange markets. Therefore, the finance function has been divided into two separate sub-functions. The upper half of the functional circle indicates the international capital markets, where long-term capital funding is negotiated and transferred. The bottom half of the circle represents the short-term exchange markets and the short-term financing of balance of payments deficits. The IMF, directly affecting the international short-term market, is connected there.

The BIS is also connected to both the international short-term financial market and to the IMF. This connection, however, is represented by a dashed line to indicate the informal nature of this interrelationship. The dashed line shows the flow of private consulting and advice between the BIS, the IMF, and the international short-term financial market. Further, connected to the BIS are the various national central banks. The heads of these central banks meet, and as a

FIGURE 3. International Financial Institutions



result of meetings and consultations, affect directly the international short-term financial market through implementation of their own national domestic monetary policies. However, through the BIS, these central bankers also have an indirect, and influential, effect on the international short-term financial market through pressures for particular policies by the International Monetary Fund.

V DEVELOPMENT INSTITUTIONS

Development is variously defined by many different authors. For purposes of this examination, however, development can be defined as "economic growth with economic structural change".[16] To achieve this structural improvement, there is only one organization which has solely a development role. This organization is the United Nations Development Programme (UNDP).

United Nations Development Programme (UNDP)

The United Nations Development Programme (UNDP) was established to provide development assistance to U.N. member countries. The UNDP is concerned primarily with the funding, implementation, and administration of international development assistance activities at the country, intercountry, and global level.[17] The UNDP is funded by the voluntary contributions of U.N. member countries, and is oriented toward specific development projects. Projects of from 2-5 years in duration in the areas of agriculture, forestry and fisheries, economic and social planning, industry, education, health, transportation and resource exploration comprise the bulk of UNDP programs. These programs are directed

16 Robert A. Flammang, "Economic Growth and Economic Development: Counterparts or Competitors?" Economic Development and Cultural Change, vol. 28, no. 1, October 1979, pp. 47-61.

17 United Nations, Yearbook of the United Nations, 1979, New York, NY: United Nations Publications, vol. 33, 1981, pp. 531-535.

toward the least developed countries, with one of the award criteria being a per capita income of less than $300 per year. Over 90% of UNDP funding is committed in the 28 least developed countries.[18]

The functional role of the UNDP is indicated in Figure 4. The direct link connects the development function of the international economy and the UNDP.

VI MULTIPLE FUNCTION INSTITUTIONS

While the existence of institutions with a sole role of achieving one of the functions identified in Figure 1 comprises a series of international economic institutions, these organizations represent only a small, although important, part of the international economic system. A larger part is played by institutions which have a role which crosses functional lines. These institutions play an important integration role, as well as providing an alternative to some of the role-specific issues addressed by the previously identified institutions. An examination of these institutions and their interrelationships follows.

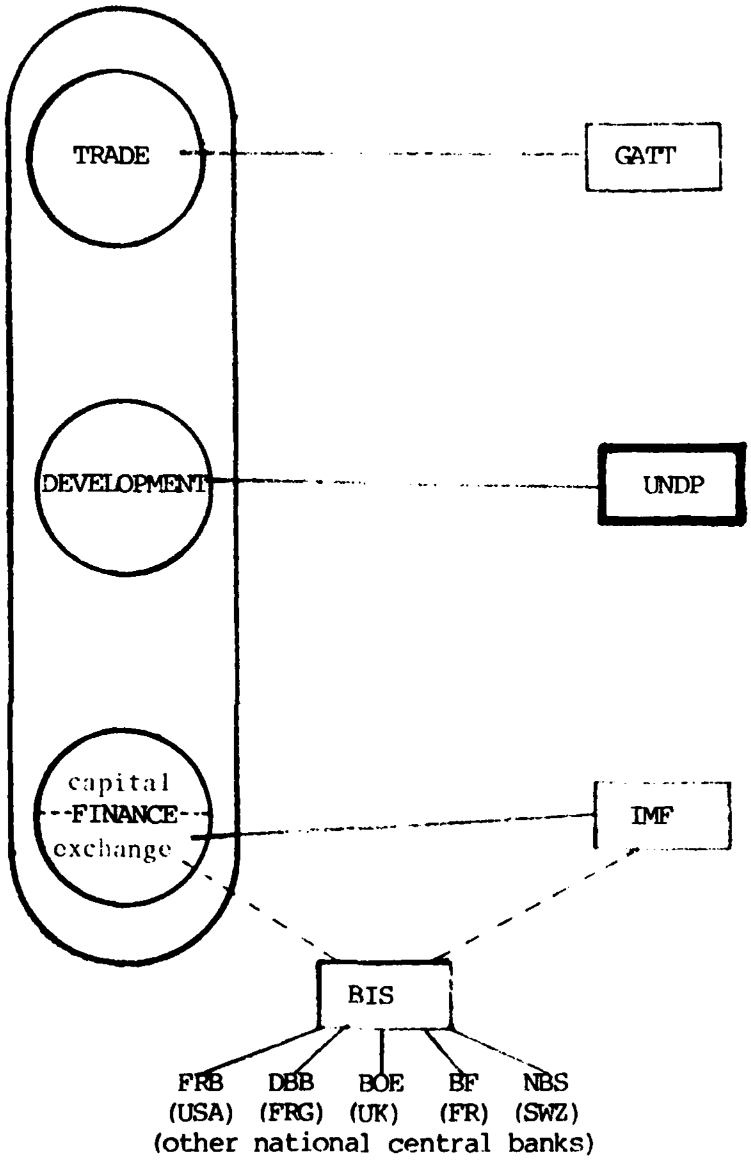
The Organization for Economic Cooperation and Development (OECD)

The Organization for Economic Cooperation and Development (OECD) is a group of the industrialized, western countries who meet formally to discuss issues of interest to their economies.[19] This organization coordinates policies on trade, financial aid, and development assistance, as well as attempts to develop consistent statistical measurement techniques for application to all individual economies worldwide. Thus, the

18 Ibid.

19 These countries include West Germany, France, Italy, Belgium, Netherlands, Luxembourg, Great Britian, Canada, the United States, Japan and Australia.

FIGURE 4. International Development Institutions



OECD is involved in all three functions of the international economy.

The OECD is another institution which was an outgrowth of the post-war arrangements made to facilitate the reconstruction of Europe. In 1948, the Convention on European Economic Cooperation (CEEC) was signed. This convention was to provide advice on the expenditure of Marshall Plan aid funds in Europe, and was also to aid in the liberalization of intra-European trade and funds transfer. The resulting organization, the Organization for European Economic Cooperation was established to facilitate achievement of these goals. The OEEC established the European Council to provide advice, and created the European Payments Union (EPU) to provide balance of payments account clearance in the most rapid manner possible. This clearance was done through the Bank for International Settlements (BIS), until the EPU was discarded in 1958.

With the move for the reconstruction of Europe, and the efforts at unification of the 1950's, the OEEC had outlived its usefulness by 1958 and was eliminated. In its place, a new organization was created. This organization, the OECD, included the United States and Canada[20] as well as the members of the OEEC. Thus, the OECD became the formal forum for the Western industrialized countries in 1960. The formal aims of the organization are (1) to promote the stability and growth of its members; (2) to promote the economic development of non-members; (3) to expand world trade on a non-discriminating basis.

The OECD is governed by the European Council, and has four major component committees, each organized within a particular functional area. The Development Assistance Committee (DAC) reviews and monitors the Official Development Assistance of the member nations. The Economic Policy Committee (EPC) maintains the primary focus of the OECD; that is, it identifies and publicizes the formal position of the OECD on

20 In 1964, Japan was added to OECD.

economic, political and policy matters. The Economic Development and Review Committee (EDRC) is the forum for policy confrontations and decisions of the member nations. It is a forum for heated debates on the future course of both the OECD and each member nation. Finally, the International Energy Agency (IEA), a funded committee of the OECD, was established in 1974 to attempt to solidify an industrialized country position on oil prices and trade, and to share oil resources in the case of a repeat of the 1973 oil embargo.

The OECD's world economic influence is illustrated in Figure 5a. The OECD is placed along the left margin to facilitate clarity. This placement is not to infer any specific superior/subordinate relationship. Within the OECD block are the abbreviations for the four major committees of the organization, to indicate the relative functions to which the OECD addresses itself. The solid lines indicate the influence of the OECD on each of the three functions of the international economy. In the case of the finance function, the OECD has an influence on both the short-term exchange market and the long-term capital market. Thus, there is a break in the functional relationship line to indicate this dual influence.

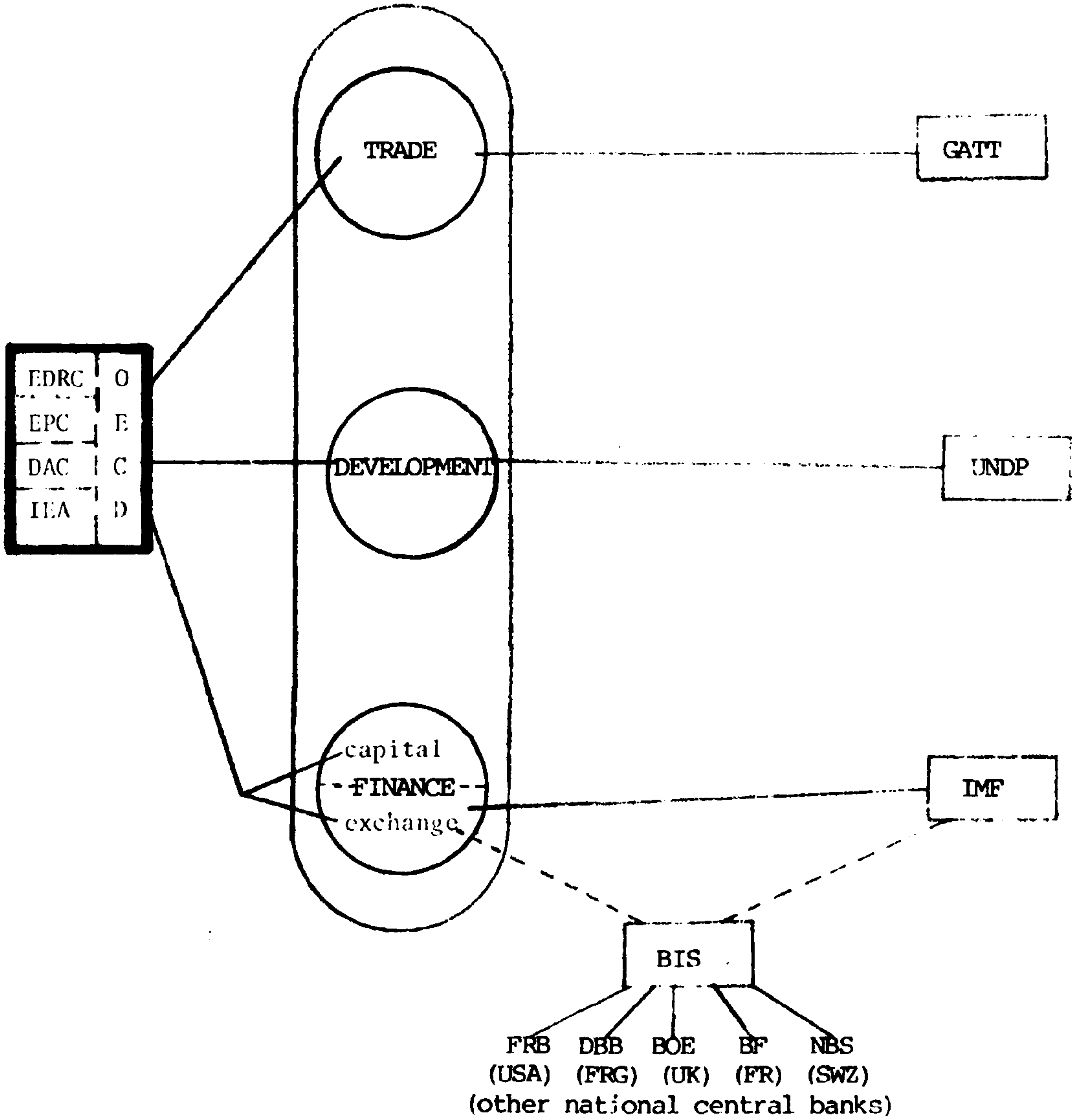
The World Bank Group

The World Bank Group, normally referred to as the "World Bank" is really composed of three separate, but interrelated institutions. These institutions are charged with helping to finance the development process of less developed countries(LDC's).

International Bank for Reconstruction and Development (IBRD)

The World Bank Group was established immediately following World War II. Its primary function was to finance the immediate post-war recon-

FIGURE 5a. Multiple Function Institutions
(Organization for Economic Cooperation and Development)



struction of the devastated European countries. As such, one of the major functional organizations, the International Bank for Reconstruction and Development (IBRD) was created to handle the capital financing and to administer the distribution of Marshall Plan aid to facilitate this reconstruction. From 1946 through 1954, Europe rebuilt. By 1955, a reconstruction facility was no longer needed, and the scope and focus of the World Bank Group changed.[21]

Rising interest in the condition of poor countries, coupled with the granting of independence to former colonies led to the need for an organization to provide long-term capital aid to the new, developing countries. With the establishment of the European Economic Community in 1958, funds previously allocated for European reconstruction could now be directed toward capital financing and development projects in less developed countries (LDCs). Since Europe no longer needed the assistance of the IBRD, its function became one of channelling capital expenditure funds from the international capital markets to the developing countries. These loans were for long time periods (from 20 to 50 years) to postpone payment until receipts from capital expenditure projects could be brought "on-line".

The IBRD borrows public funds in the international capital markets through the sale of its own bonds to investors. It then lends these monies to developing countries at market interest rates, to be repaid with interest after some specified grace period. These loans contain conditions which are placed on the borrower country. These conditions usually require changes in the domestic economy of the borrower country; such conditions as improved market mechanisms, anti-inflation policies, and the like. The borrower must accept these conditions in order to re-

21 MacBean and Snowden, Op. Cit., pp. 211-230.

duce the need to borrow these funds in future periods.[22]

International Finance Corporation (IFC)

The International Finance Corporation (IFC) is the second major subordinate institution of the World Bank Group. This organization was established in 1956 with the primary objective of encouraging private lending for individual enterprises in developing countries. The IFC obtains private funds from the international capital markets, and then recycles these funds into development loans to developing countries. These loans of from $1 to $20 million are similar to those of the IBRD, carrying the market interest rate, and being due, with interest, after some specified grace period. These loans do not require government guarantee of the loan, and are not subject to the same conditionality provisions of an IBRD loan. IFC loans provide only a portion of the required funds (between 25% and 50%), with the remaining funds coming directly from private funding sources.

International Development Association (IDA)

The International Development Association (IDA), the third of the World Bank Group's major subordinate organizations, is also a bank lending agency. Established in 1962 in response to criticisms of over-conservatism on the part of the IBRD, the IDA provides a channel for funding to those countries whose repayment ability is limited by extensive balance of payments deficits. The IDA obtains contributions from member countries, and recycles these contributions to the developing countries as low-cost loans. These loans carry an interest rate well below the market rate, and payment provisions are liberally extended to

22 This conditionality has led to criticism of the IBRD. These criticisms contend that the IBRD is biased toward a market-oriented economy, and the conditions placed on IBRD loans do not leave sufficient room for the national administration to maneuver the domestic economy toward national goals through economic planning. MacBean and Snowden, Op. Cit., pp. 218-219.

allow capital investments to pay for their financing after the investments themselves are completed and operational.[23] However, to obtain these loans, developing countries must provide significant amounts of information about their domestic and international economies, and accept recommendations from the IDA for changes in their economic structure in exchange for low-cost loans. This conditionality is similar to that applied by the IBRD, but is slightly less restrictive on individual national economies.

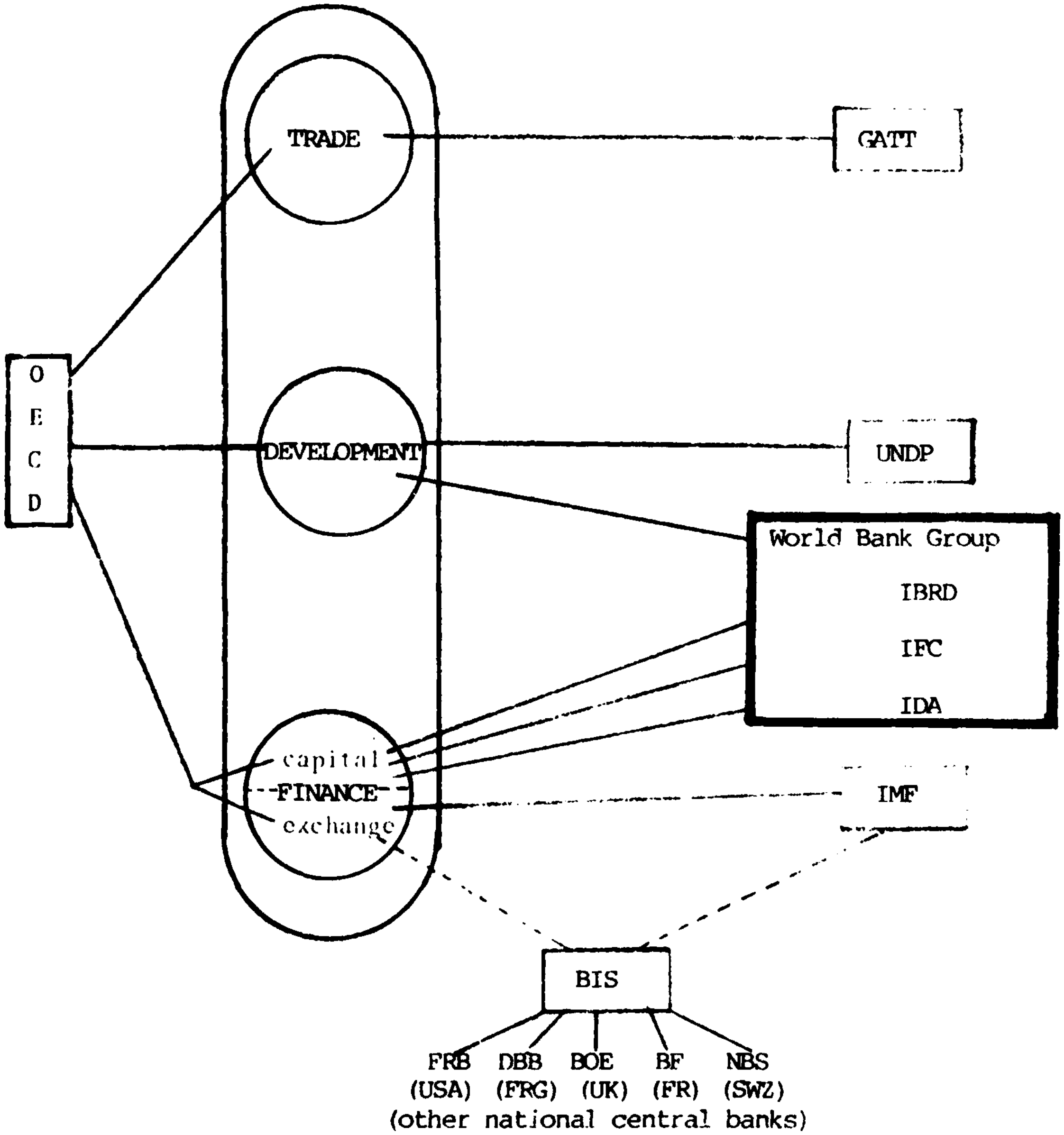
Thus, the World Bank Group, through its three subordinate organizations, provides the long-term lending capacity of the international economy, an activity which is directly complemented by the short-term activities of the International Monetary Fund in the international financial markets. Figure 5b shows the role of the World Bank Group in relation to both the finance and the development functions of the international economy. The entire group is enclosed in a single box to indicate the relationship between the managerial and functional responsibilities of these organizations. The World Bank Group is connected from the international capital market (long-term funds) to the development function to indicate the Group's role as a transfer agent. The connection from the capital market to each of the subfunctions indicates the difference in the type of capital financing being transferred.

United Nations Conference on Trade and Development

The United Nations Conference on Trade and Development (UNCTAD) arose in 1962 as both an outgrowth of, and a reaction to, the results of the Dillon Round of trade negotiations in the GATT, and the proposals for what became the Kennedy Round of negotiations in 1963-1967. It represents the developing countries' response to these negotiations, at which the LDCs believe the industrialized countries ignored the LDC's

23 This is the "soft loan window" of the World Bank.

FIGURE 5b. Multiple Function Institutions
(The World Bank Group)



desires and needs.

The UNCTAD arose as a result of a theoretical postulation by Raul Prebisch, the first chairman of the U.N. Economic and Social Council (UNECOSOC). His theses were twofold, namely: (1) the prices of primary products (the major export commodity in most developing economies) were falling in world markets, and this fall would continue and (2) the prices of manufactures (the primary import products of most developing countries) was rising, and would continue to do so.[24] Therefore, Prebisch concluded that the "terms of trade" between the developing and the developed countries were worsening, and this also was bound to continue.

Due to the wide popularity of this thesis in the LDCs, a move for a separate organization which would address the needs of these LDC's arose. In this movement, the LDC's linked trade problems to development measures, and a reaction to the dictates of the industrialized world became the motive force behind an international conference held in Geneva in 1964. The results of this conference, entitled the United Nations Conference on Trade and Development, became the agenda for the newly established U.N. organization which today bears the same name.[25]

The basic aims of the original UNCTAD were to increase foreign exchange earnings of the developing countries to avoid the decline predicted by the Prebisch thesis. The means to achieve this increase in foreign exchange included: increased aid from developed to developing countries; international commodity agreements to stabilize international primary product prices; tariff preferences in developed countries for developing country goods, especially manufactures. The end result would be diversified developing country economies which would be self-

24 MacBean and Snowden, Op. Cit., pp. 97-98.
25 The first full-time head of the UNCTAD organization was also Dr. Raul Prebisch.

supporting.[26]

The initial conference resulted in little, except to create a unified voice for the developing countries. There have been five additional UNCTAD conferences since 1964, but the results have also been disappointing. The single major accomplishment has been the creation of a "General Scheme of Preferences" (GSP), which identifies specific tariff preferences for developing country goods crossing developed country borders. Yet, UNCTAD remains a major forum for the statement of developing country needs and desires, and has succeeded in being heard in the developed world.[27]

Figure 5c shows the relationship between the UNCTAD and the international functions of trade and development. The solid lines connect to these two functions. Additionally, because of UNCTAD's interest in trade and tariff issues, there is a significant amount of crossfeed between UNCTAD and GATT. Thus, a dashed line has been added between these two organizations, as indicated.

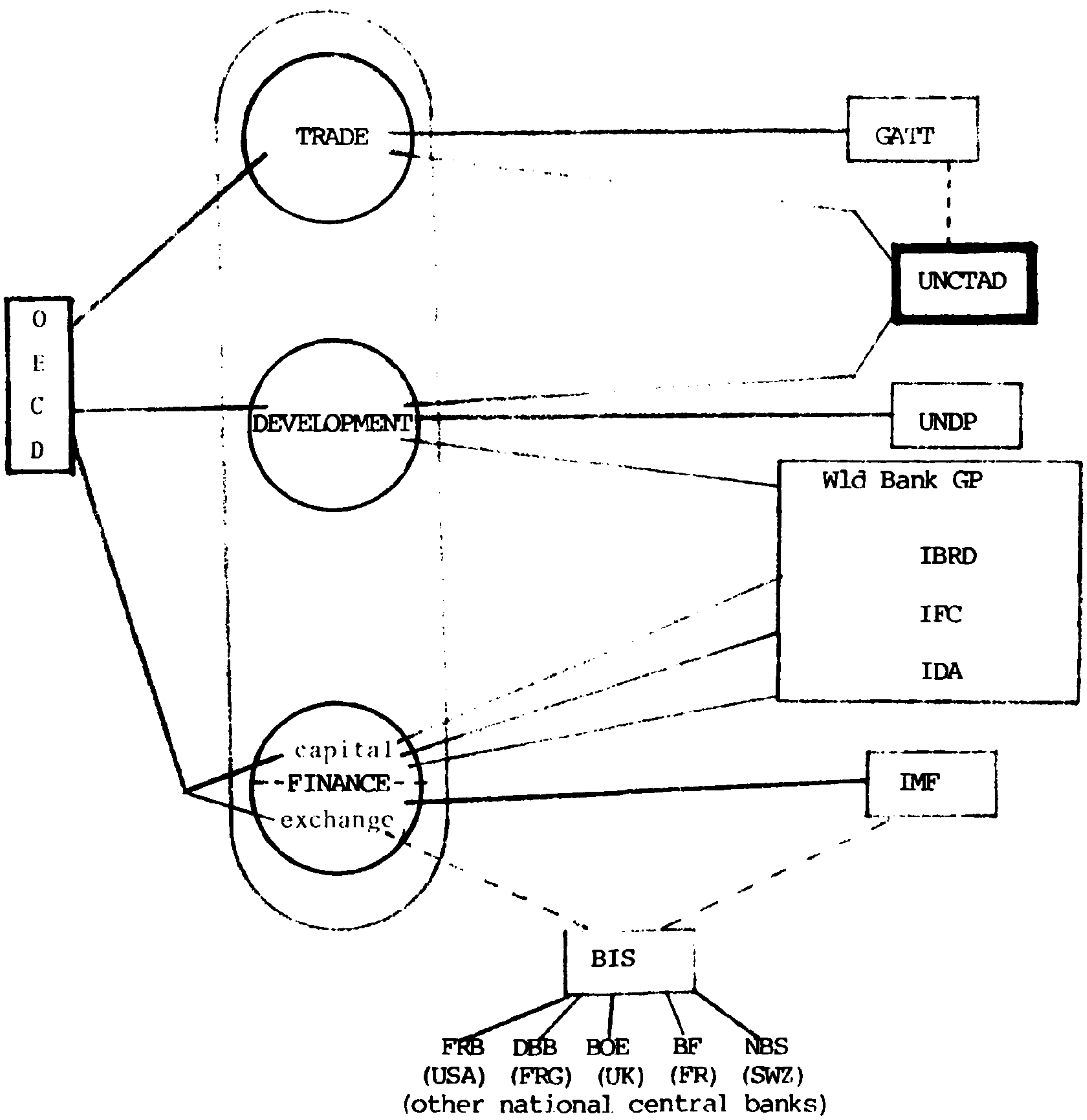
United Nations Economic Commissions

There are five economic "commissions" created by the United Nations General Assembly which deal with a combination of trade and development issues. Each of these commissions has a charter which is similar in

26 Ibid. p. 95. Also, UNCTAD, Basic Documents on Its Establishment and Activities, New York, NY: U. N. Publications, 1967, pp. 13-27.

27 The UNCTAD is the major forum for elaboration of economic issues within the context of a much broader North-South debate. This debate between developed and developing countries encompasses political, social and cultural issues as well as economic ones. This entire debate takes place under the call for a "New International Economic Order" (NIEO). MacBean and Snowden, Op. Cit., pp. 108-109.

FIGURE 5c. Multiple Function Institutions
(The U. N. Conference on Trade and Development)



nature: to study various aspects of economic, social and cultural development processes, and report their findings to the General Assembly for action. These commissions are as follows.

U.N. Economic and Social Council (ECOSOC)

The U.N. Economic and Social Council (UNECOSOC) has the broadest of functions. It is directly responsible to the General Assembly (GA) for study and implementation of economic, social, cultural, education and health programs as directed by the General Assembly. It then conducts analysis and recommends the proper policies to follow to achieve alternative goals in these areas.[28] It has only advisory, not functional authority in the international economic system. The UNECOSOC also has supervisory authority over the five regional economic commissions listed below.

U.N. Economic Commission for Africa (ECA)

The UNECA initiates measures for economic development of Africa, with a view toward raising both economic growth and standards of living in Africa.[29] UNECA oversees funding distribution for regional and national development projects within the African region, such as school construction, construction of sanitation facilities, water treatment and distribution projects, etc.

U.N. Economic and Social Commission for Asia and the Pacific (ESCAP)

UNESCAP was originally known as the Economic Commission for Asia and the Far East (UNECAFE), but the name was changed in 1974 to its current title. UNESCAP has the same functions in Asia that UNECA has for Africa.[30]

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28 Min-chuan Ku, ed., Op. Cit., pp. 118-120.
29 Ibid, p. 554.
30 Ibid, p. 572.

U.N. Economic Commission for Europe (ECE)

The formal charter for UNECE reflects the thinking during the establishment of this regional commission directed at Europe.

> is charged with designing measures for facilitating concerted action for the economic reconstruction of Europe, for raising the level of European economic activity, and for maintaining and strengthening the economic relations of the European countries, both among themselves and with other countries of the world.[31]

In the case of this commission, since Europe represents one of the most developed regions in the world, most of the activity of this commission is directed at promoting improved trade and development relations between Europe and the developing countries of the world.

U.N. Economic Commission for Latin America (ECLA)

As with the other three regional commissions, UNECLA promotes development projects and studies dealing with the improvement of economic and social conditions in the Latin American region.[32]

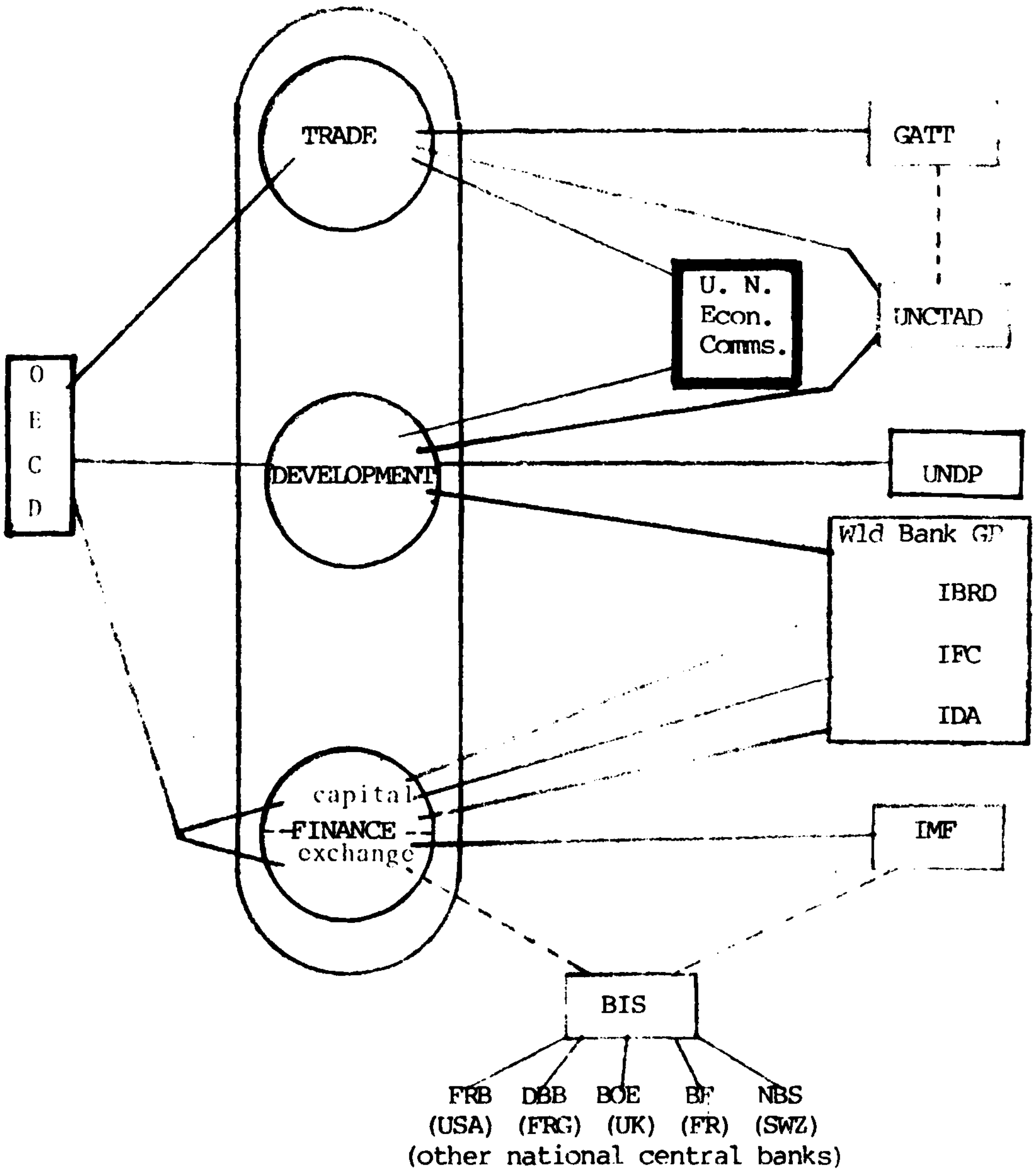
U. N. Economic Commission for Western Asia (ECWA)

The Economic Commission for Western Asia (UNECWA) is a relatively recent development, having been established in 1973. As with the other commissions, UNECWA promotes developmental studies dealing with the improvement of economic and social conditions in the Middle East and Persian Gulf region (from the Suez Canal to Pakistan).

The functional relationship of these economic commissions is indicated in Figure 5d. The institutional box is entitled U. N. Econ. Comms. to indicate not only the interrelatedness of these commissions, but also their relative size in the international economy. They are

31 *Ibid*, p. 584.
32 *Ibid*, p. 595.

FIGURE 5d. Multiple Function Institutions
(U. N. Economic Commissions)



functionally linked to both trade and development.

Regional Cooperative Organizations

In an attempt to improve trade relations, several regional organizations have developed over the past two decades. None has been more successful than the European Economic Community, which has resulted in a reconstituted and more economically unified Europe. All of these regional associations attempt to improve trade through the broadening of markets for domestically produced goods.[33] Such attempts are based on strong theoretical foundations.

Theoretically, there are six levels of economic integration. The first is called a preferential trading agreement, which exists as a result of the reduction of mutual trade barriers among the partners. The second stage is a free trade area, in which mutual trade barriers are entirely eliminated. The third stage is called a customs union, in which not only are there no trade barriers between trading partners, but there is also a common set of trade barriers to external trading countries. The fourth step in economic integration is the allowance of the free movement of factors of production among the member nations, which is called a common market. The fifth step in this integration is the harmonization of the fiscal and monetary policies of all the member nations, to include a fixed exchange rate between each of the national currencies within the "monetary union". The final step is called an economic union, in which common monetary and fiscal policies are set by some central authority for the good of the union rather than the benefit of any one individual nation. These steps can be applied to the experience of the European Economic Community.[34]

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33 This list is certainly not all-inclusive. Only those major regional organizations associated with economic issues are included, primarily for illustration purposes, and to indicate the general record of progress.

34 Franklin R. Root, International Trade and Investment, Cincinnati, OH: Southwestern Publishing Co., 1977, pp. 197-218.

The European Economic Community (EEC) has progressed through the first four steps of economic integration. The establishment of the European Monetary System in 1979 was the beginning of the fifth step in the European attempt at economic integration.[35] Because it is the first effective union from the practical standpoint, it represents a model against which to compare other efforts at economic integration. The EEC began in 1958, as a follow-on organization to the European Coal and Steel Community (ECSC). The original members of the EEC were Belgium, France, the Federal Republic of Germany, Italy, Luxembourg and the Netherlands. Britain, Ireland and Denmark were added in 1973, and Greece was added in 1981, for a total membership of ten nations.

The Association of Southeast Asian Nations (ASEAN) is a regional association between 6 countries bordering the South China Sea. These countries are Indonesia, Malaysia, Thailand, Singapore, and the Philippines.[36] Progress in this union has been slow, with only recent establishment of lower, preferential tariffs for members. Thus, this organization remains at the first stage of integration.

The Central African Customs and Economic Union (CACEU) has as its ultimate goal the achievement of a customs union. However, the members, Cameroon, the Central African Republic, the Congo, and Gabon, remain at the initial negotiation stage.

The Carribbean Community (CARICOM) was established in 1973, to replace the Carribbean Free Trade Area (CARIFTA) which was established in 1967. CARICOM has progressed toward a common tariff on goods produced within the community. As such, it has reached the customs union stage. However, because all internal trade restrictions have not yet been removed, work towards a complete customs union remains to be

35 Ibid.

36 Brunei became the sixth member on January 1, 1984.

accomplished. CARICOM includes Antigua, the Bahamas, Barbados, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Kitts-Nevis-Anguilla, Santa Lucia, Saint Vincent-Grenadines, and Trinidad-Tobago, all relatively small island nations.

The Central American Common Market (CACM) was established in 1961 to provide larger markets for the small Central American countries of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Little progress was made in the early years, and in 1975 this organization was incorporated into the Latin American Economic System (see below).

The Council of Mutual Economic Assistance (CMEA) is another organization with the stated goal of total economic integration. This organization came into existence in 1949, and is the oldest post-war attempt at integration. This regional cooperative association was originally composed entirely of Eastern European countries, under the direct supervision of the Soviet Union. However, others have been added since its inception, with current membership including Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, the Soviet Union, and inactively since 1961, Albania. In addition, North Korea, the People's Democratic Republic of Yemen (North Yemen) and Vietnam are listed as "observers".

Integration in this organization has taken place slowly, but many mutual organizations have been established to deal with specific issues important to the entire group. These include standing committees to address such issues as trade, currency matters, statistical reporting, standardization, various heavy industries, and many others. Two organizations of financial importance are the International Bank for Economic Cooperation (IBEC) and International Investment Bank (IIB). The IBEC manages group financial matters relating to currency exchange and other financial issues, while the IIB deals with long term capital expansion issues within the group. To some extent, these functions are comparable to the IMF and World Bank Group activities respectively. However, the management issues and the integration goal in this organization is of an entirely diffferent nature than that of the EEC.

Obtaining valid statistical data to make international comparisons when dealing with Eastern Bloc countries is difficult. To the extent data is available, they appear to have achieved a customs union.[37]

The East African Common Market (EACM) was established in 1963, but due to the inability of the participants to agree on political and economic issues, it was disbanded in 1977.

The Latin American Economic System (LAES) was formally established in 1975, and is a follow-on organization to the Latin American Free Trade Association (LAFTA) originally established in 1963. This organization also incorporates the members of Central American Common Market (CACM) as well as individual members of CARICOM. There are currently 28 members, all in Central America, South America and the Carribbean areas. The LAES seeks to achieve a customs union in Central and South America, but due to the disparity of interests among the member nations, has not progressed beyond a formalization of preferential trading agreements between some of the member states.

The West African Common Market (WACM) is another African organization attempting to combine the resources and markets of several adjacent countries. Because resources are scarce, this arrangement has also made little progress toward economic integration. Members of this organization include the Ivory Coast, Mali, Mauritania, Senegal, Upper Volta, Niger and two observers, Benin and Togo.

37 Since trade barriers between these countries are not indicative of resource barriers, the attempt at analysis using current Western theory must be qualified as "vague", to say the least.

The Group of African, Carribbean and Pacific States (ACP Group) is a rather loosely-knit organization which, under the umbrella of UNCTAD negotiations, has reached a formal treaty agreement with the European Economic Community concerning tariffs and trade preferences. Called the Lomé Convention, it provides the basis for trade and development aid between these two diverse groups of nations. Initiated in 1975, it has been renewed twice, and seems to be the model of future sub-global trade arrangements.[38]

None of these regional cooperative organizations has enjoyed the success that the European Economic Community has acheived. Europe has a much longer history of mutual trade than do the other regions, due in large measure to the relatively different national comparative advantages. Further, there are more political, economic and social similarities in Europe than in the other regional organizations mentioned. Yet, efforts at regional integration in other parts of the world continue, despite the added difficulties of more diverse traditional relationships and much more similar comparative advantages.

Figure 5e indicates the relative position of the various regional cooperative organizations in the international economy. Rather than include them individually, they are all included between trade and development as a group. This group shows the movement from trade to development throught the creation of these various regional cooperative associations.

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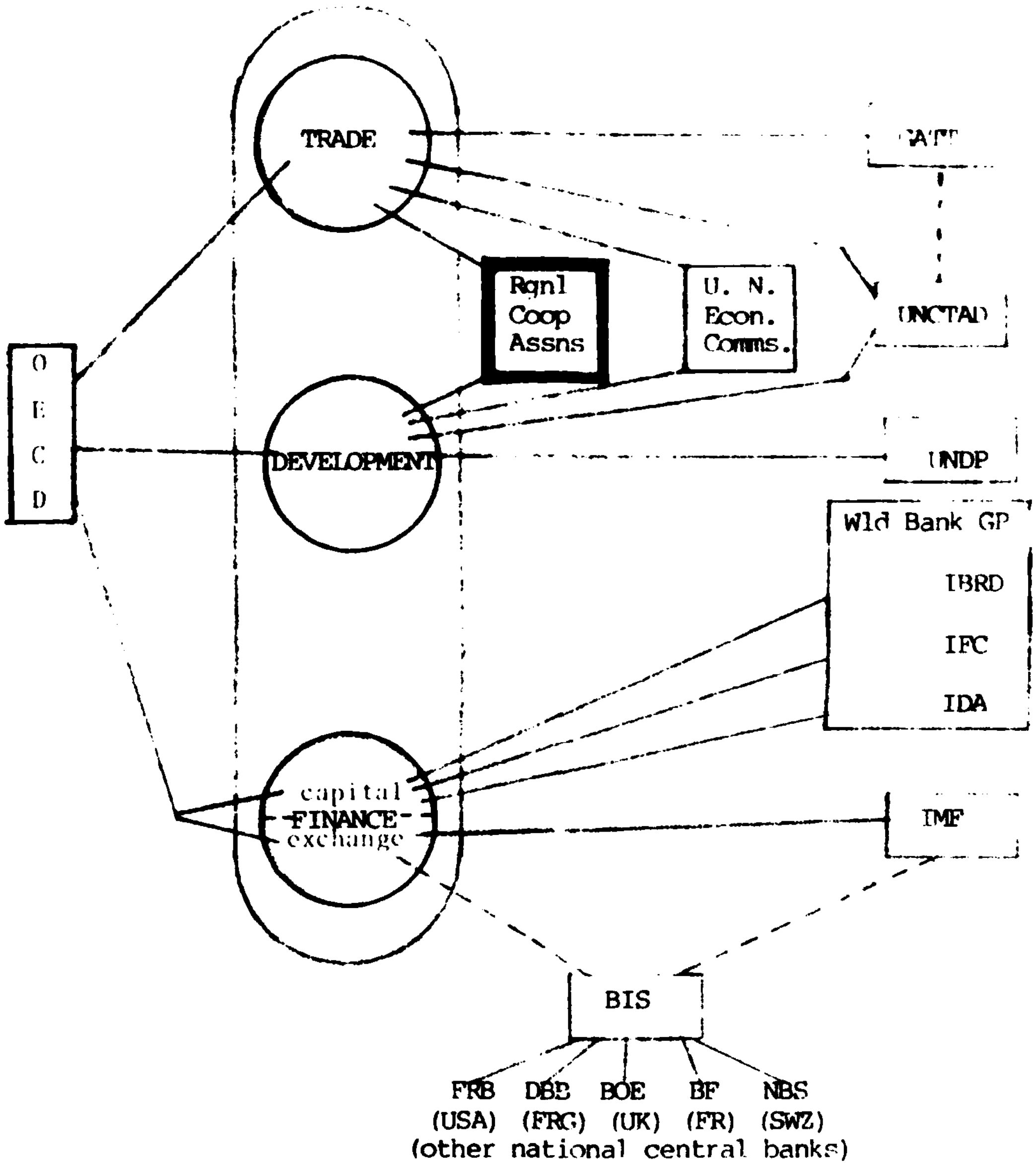
38 One of the major reasons for the success of this effort is that most of the member countries of the ACP Group were former colonies of Western European countries. As such, they have built a trading foundation upon which they have been able to capitalize.

FIGURE 5e. Multiple Function Institutions
(Regional Cooperative Associations)



Other International Economic Institutions

In this category fall several sub-categories of institutions which have functional relationships within the international economy, but whose function also supercedes that of individual economies alone. These institutions also have roles in the international political, social and/or cultural processes, but are included here only for their economic influence.

Regional Development Banks

This major group of institutions functions to provide regional development funds to member countries through a formal lending facility. These regional banks obtain their funds from the international capital markets by selling stock, and also obtain funds through the subscriptions and donations of member nations. A regional board of governors then normally makes determinations as to what projects, countries and programs should be funded.[39] The major regional development banks are as follows.

The African Development Bank (ADB) was formed in 1963 to provide funds for development assistance to African nations. Currently, there are 47 member nations, all on the African continent.

The Asian Development Bank (DBA) provides direct loans to individuals for venture capital, as well as providing development loans to nations who are members. The DBA is also responsible for executing UNDP programs in its area of responsibility. However, it is not tied to the United Nations umbrella. There are currently 28 Asian country members, as well as the U. S., Canada and the European Economic Community.

39 Union of International Associations and the Internationa Chamber of Commerce, Yearbook of International Organizations, 1981, Utrecht, Netherlands: Van-Boekhoven-Bosch, 1982, various pages.

The Central American Bank for Economic Integration (CABEI) provides development assistance to member Central American countries. Its assets are relatively small, and there are only six Central American members.

The European Investment Bank (EIB) provides private funds for development assistance to the lesser developed regions of Western Europe. However, in the recent past the role of the EIB has expanded to include Greece, Turkey, and several North African nations. Additionally, the EIB has assumed a development banking role in the transfer of European aid funds to the ACP Group under the Lomé Convention. (See page 33)

The Inter-American Development Bank (IADB) was established in 1959 as a part of the Organization of American States (OAS). It provides the budgetary function for the OAS, and provides development assistance to all member countries in the western hemisphere. It is one of the largest development banks in terms of the financial assets available. All OAS countries are members, and may borrow against these assets for development projects. In practice, the U.S. and the U.K. are the major contributors and the other members are borrowers, with the permission of the OAS heirarchy itself.

The International Investment Bank (IIB) is the funding arm of the CMEA, the Eastern European Common Market. It makes resources available to members for infrastructure development, as long as those loans are consistent with the "international division of labor". Since funding is in non-convertible Rubles, there is very little interaction with the western international economy. However, this bank has, in the past, made loans to non-member countries at very concessional terms. These loans have been made for their influence value rather than through the use of accepted international banking criteria.

The Carribbean Development Bank (CDB) is the funding arm of CARICOM, with the assistance of both the U.S. and the U.K. It provides development loans to members especially in the areas of agriculture, tourism, light manufacturing and forestry and fisheries. There are 18 Carribbean members, with the U. S. and U. K. as associate members.

The East African Development Bank (EADB) is a consortium for the funding of the CACEU, with the assistance of six large European banks. These banks channel funds to the CACEU members solely for development-type projects.

The West African Development Bank (WADB) provides development and project assistance to members of the West African Common Market. It is the smallest, in terms of available assets, of all the major development banks.

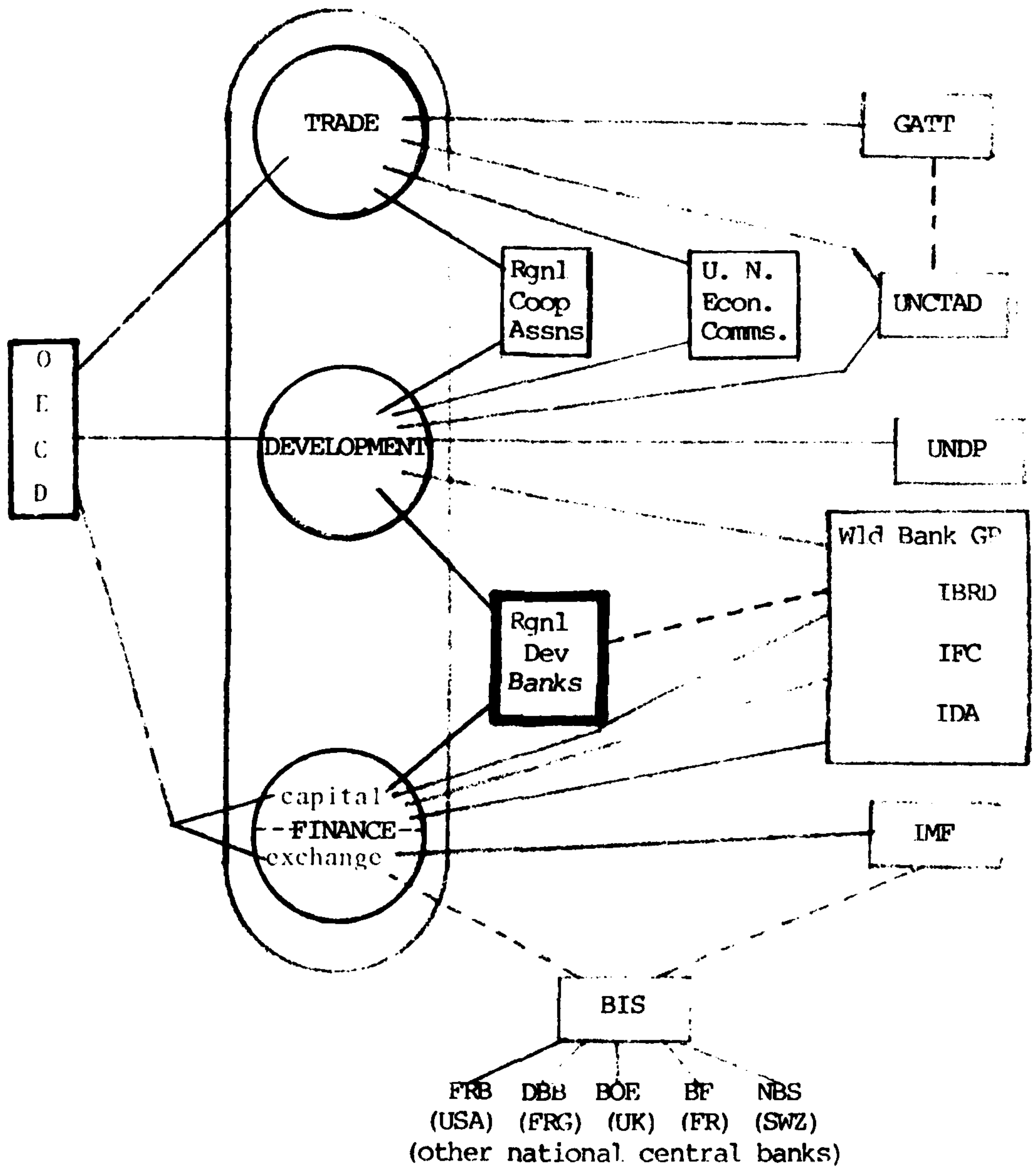
The Islamic Development Bank (IDB) provides development funds to religiously pure, (as defined by the major contributors) developing Islamic countries in North Africa, the Middle East and South Asia. These funds are available only at market interest rates for relatively short periods (10 years or less).

Figure 5f indicates the role of the various regional development banks in the international economy. Notice the solid line from the capital market portion of the finance function, through the regional development bank block, to the development function. Also, to indicate the interaction between these regional development banks and the World Bank Group, a dashed line has been added.

Others

Two additional organizations bear mention in any discussion of the international economy. These organizations are primarily fora for discussion and negotiation, but their deliberations have had some economic

FIGURE 5f. Multiple Function Institutions
(Regional Development Banks)



impacts as well.[40]

The Organization of American States (OAS) is an organization for the discussion and implementation of policies of benefit to the members of the Western hemisphere. Many of their pronouncements have resulted in directing the trade and development efforts of their member nations, and specifically in directing use of the funds available to the Inter-American Development Bank.

The Organization of African Unity (OAU) has been primarily a political body. Yet, in supporting the efforts of the OPEC countries in raising world oil prices, and in the recommendation of funding measures by various regional development banks, this organization has had a significant impact on both the finance and development functions of the international economy.

Because of the basic political nature of these organizations, they are not included in any of the figures presented here. Yet, it is important to acknowledge their role in the international economy.

VII FORMAL AND INFORMAL AUTHORITY RELATIONSHIPS

Figure 5f (page 39) is the final integration of the structure of the international economic system with its functions. This system has developed, over time, as a pragmatic response to changing conditions in the international economy. For example, GATT was originally designed as a temporary response to a short-term situation, yet it remains a viable organization in its fourth decade of operation. The development of the UNCTAD in 1962-1964 was also a response to a perceived deficiency in the then existing international economic arena. Additionally, organizational roles have changed to adapt to the international environment,

40 Ibid.

such as the IMF's creation of a "medium-term" lending capability through the creation of various "facilities".[41]

One final point bears discussion. This system is a combination of those organizations existing within the United Nations umbrella and those organizations which act outside the United Nations structure. Table 1 lists this dichotomy. Major organizations which function outside the United Nations umbrella are identified as "Independent",[42] while United Nations organizations are listed according to their authoritative association within the United Nations.

Further, for illustrative purposes, Figure 5f has been reproduced as Figure 6. However, those organizations which fall within the United Nations umbrella are highlighted with a dotted-line perimeter. This highlighting has some important implications for the study of international economic activity.

First, activities outside the dashed-line perimeter are conducted on the basis of the economic interests of the particular organizational constituency. For example, it has been charged that both the OECD and the GATT exist to serve the interests of the developed, industrialized Western countries.[43]

Second, while the activities within the dashed-line perimeter can be attributed to the auspices of the United Nations, there exists here a dichotomy as well. Those organizations which are agents of the General Assembly of the United Nations (UNCTAD, UNDP, UNECOSOC and the U.N. Economic Commissions) serve the interests of the General Assembly, which

41 See footnote 14, page 9 of this report.

42 This title may connotate more lattitude of action than exists in reality, yet a better descriptor does not exist.

43 MacBean and Snowden, Op. Cit., pp. 213-214.

TABLE 1. Organizational Affiliation

INDEPENDENT

Organization for Economic Cooperation and Development (OECD)

General Agreement on Tariffs and Trade (GATT)

Bank for International Settlements (BIS)

Regional Cooperative Associations

Regional Development Banks

UNITED NATIONS

General Assembly

United Nations Development Programme (UNDP)

United Nations Economic and Social Commission (UNECOSOC)

United Nations Regional Economic Commissions (5)

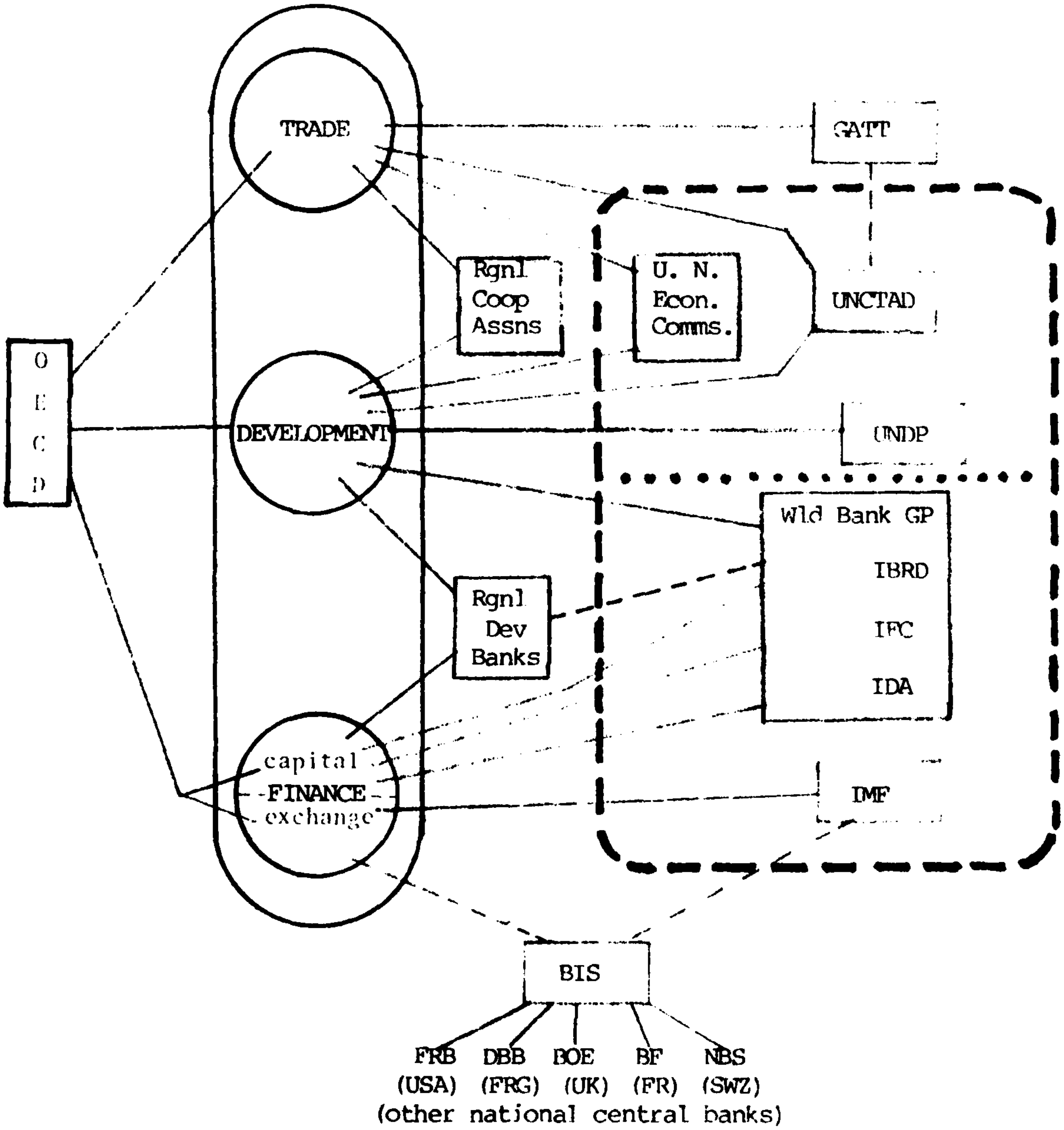
United Nations Conference on Trade and Development (UNCTAD)

Independent Agencies

International Monetary Fund (IMF)

World Bank Group

FIGURE 6. The International System Complete



is governed by majority rule. Since the majority of these countries are LDC's, these organizations serve the interests of their constituencies, the LDC's. But the two major independent international economic organizations which are members of the United Nations system, the IMF and the World Bank Group, have been charged with the same kinds of bias as the non-United Nations organizations mentioned earlier.[44]

This charge is levied because the constituency of these organizations appears to be the industrialized, western countries. Membership in the IMF and the World Bank Group is based on the relative size of the nations' international economic participation. Thus, because the United States is the largest world trader, its vote has significantly greater weight within these organizations than do the smaller trading countries. Similarly, since the European Community, as a group, is the second largest world trader, its vote carries significantly more weight than those of the smaller countries. The U. S. votes about 20% of the weight, and the combined weight of the vote of the U. S., the European Community and Japan is approximately 50% of the total vote. Thus, these countries have a "trade-weighted" majority in these organizations, thereby significantly affecting the decisions made by these organizations. This is further exacerbated by the near-total autonomy with which these organizations operate within the United Nations umbrella. This difference is indicated in Figure 6. General Assembly organizations are above the dotted line within the dashed enclosure, while the independent organizations are below the dotted line, but within the dashed box.

VIII SUMMARY

The international economy has developed slowly, as a response to changing international economic conditions and political realities. These changes have resulted in the creation of institutions to serve the

44 Ibid.

needs of the various international economic participants. These institutions revolve around the functions of international trade, international finance, and international economic development. Some of these institutions fulfill a single function, such as the GATT, UNDP, and the IMF and BIS. Other institutions are involved in more than one function simultaneously, such as the World Bank Group, the UNCTAD, and the various regional organizations.

Changes have come slowly, and only in response to extensive pressures for these changes. For example, the UNCTAD was established in response to pressures for change in the manner in which tariff and non-tariff barrier negotiations are conducted. Some of these same pressures exist today, and can be expected to generate a requirement to either change the roles of current institutions or to create new institutions to reduce these pressures. Further, new pressures are being generated through the call for a New International Economic Order (NIEO) as well as through other dynamic forces which have recently arisen. Yet, the international economy has demonstrated a dynamic resilience in its ability to adapt to these pressures, and will continue to adapt to pressures in the future.

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