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***European Community Trade Barriers to Tropical Agricultural Products*. By Michael Davenport.** ODI Working Paper 27. London, November 1988.

Exports of tropical products to the European Community (EC) are an important source of foreign exchange for a number of ASEAN countries. Thailand, Indonesia, Malaysia, and the Philippines are the major exporters, and economists in each of these countries will find much of interest in the present study. The general reader will also appreciate Davenport's clear, compact, and well-researched analysis of EC trade policy towards tropical products.

The paper examines the implications of a number of trade liberalization and tax measures that could be taken by the EC. These include the abolition of tariffs, the removal of VERs, and the lowering of internal taxes on products such as cocoa and coffee. The problem of tariff escalation is also addressed. Attention is focused on a selection of commodities: cocoa, coffee, tobacco, rice, cassava (manioc), and the principal tropical oils. Together they accounted for 11 billion ECUs of exports to the EC in the mid-eighties, or some 3 per cent of total EC imports from developing countries.

Tropical *agricultural* products are the subject of this research. Wood, rubber, jute, and spices are excluded presumably because of the low degree of EC protection. Sugar is the subject of a separate study. Bananas and some other tropical fruits involve special difficulties between preferential and non-preferential sources of supply in the developing countries. Among the products chosen for study, rice, manioc, raw tobacco, and certain oils interact closely with the Common Agricultural Policy (CAP) and for that reason have been excluded from the Community's initial Uruguay Round proposals for tropical products. The Commission justifies this exclusion on the grounds that CAP-competing products should be considered in the context of negotiations on agriculture. Davenport shows that some liberalization could be implemented to the benefit of developing countries without provoking a large increase in CAP expenditure.

The paper uses a partial equilibrium methodology, drawing on already existing elasticity estimates and mid-eighties trade data. The analysis is supplemented by a commodity-by-commodity description and evaluation of EC trade policy towards each product. For each product, the trade effects of a more liberal policy are quantified in terms of consequences for EC imports, ACP exports and GSP-country exports. The effects on the world price level and on welfare (broken down by the same three major groups) are also estimated.

There are three major findings. First, developing countries would gain in respect of both increased trade and welfare from a more liberal EC policy. Second, the EC consumer would also benefit — a result which conflicts with the subliminal assumption in some circles that removal of import barriers creates a "burden" on the Community. Third, a large part (650m ECU) of the combined welfare gains to the developing countries would accrue as a consequence of the elimination of tariffs and internal taxes on coffee. The welfare gains to the EC consumer emerge as almost equally high — though this result overlooks any collection costs incurred in finding an alternative source of tax revenue. The search for approximation of taxes around a standard rate by 1992 must discourage the introduction of zero-rate taxes no matter how deserving the cause.

The analysis of the effects of VERs imposed on Thailand's cassava exports is an interesting addition to the literature on this form of protection. As is often the case, the producers have been successful in expropriating a large share of the economic rent created by the quota. The amount of rent is estimated as no less than 37 per cent of Thai cassava export revenues. Given the high proportion of foreign involvement in this activity (80 per cent in 1980), the welfare effects for the economy of Thailand would need careful analysis. In any

event, there seems to be some inconsistency between the estimates in Table 7.5 and Table 2 on this issue. The paper ends with the conclusion that tariff cuts on unprocessed goods will have to be accompanied by steep reductions in protection of processed goods. Otherwise there is a danger that the Uruguay Round will increase effective protection on the developing countries' processing industries.

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Financial Liberalization and Economic Development: A Reassessment of Interest-Rate Policies in Asia and Latin America. **By Ronald I. McKinnon.** San Francisco, California, 1988. Pp. 48.

In 1973, Ronald McKinnon published a seminal book relating financial development to economic development. The message was that "repressed" financial markets had to be liberalized before economic growth could take off. This message ran counter to that preached by many development economists at the time: their view was that credit to the industrial sector should be subsidized. Moreover, they advocated "forced" saving through inflation. Unless the financial sector was manipulated or repressed in this fashion, they argued, it could not lead the development process.

By now, that view has been almost totally discredited. It is widely agreed that saving and investment should be voluntary, and that interest rates should be at market levels. Only then can substantial flows of loanable funds be generated, and allocated efficiently to the most productive final users. Also, everyone now agrees that high inflation is completely disfunctional since it dramatically distorts relative prices and signals for resource allocation; in addition it leads to socially wasteful hedging.

But what is no longer clear is whether rapid financial liberalization will work unless inflation has already been brought well under control. In the late 1970s and early 1980s, Argentina, Chile, and Uruguay all tried to deregulate their banks and fight inflation at the same time. Real interest rates skyrocketed. There were two unfortunate results. First, dozens of banks failed, or nearly failed and had to be bailed out, because they were induced to make high risk loans. Second, high interest rates sucked in foreign capital, and debt burdens rose sharply. The question thus arises whether financial liberalization ought not to be slowed down until inflation is fully licked.

Professor McKinnon's 1988 monograph begins with some cross-country comparisons of interest rates, inflation, and real financial growth. He shows that countries with high real financial growth — defined as growth in ratios of money supplies to GNP — are also countries with high real output growth. The countries he identifies are Germany, Japan, Korea, Taiwan, and Singapore. He then shows that among developing countries, positive real interest rates have also been associated with high real growth. He concludes that non-repressive financial policies contribute to higher economic growth.

The monograph then looks at post-war Japan. It is argued that despite superficial appearances, the post-war Japanese financial system was not particularly over-regulated. But neither, initially, was the banking system fully liberalized. There were ceilings on interest rates, and banks were not allowed to borrow freely abroad: liberalization began only in the late 1970s. The Japanese proceeded cautiously. First, they established a record of stabilized monetary growth and low inflation; second, they laid an infrastructure of broad and deep non-bank capital markets: securities trading and finance, insurance and pension firms. Third, they never relied on the banking sector exclusively to intermediate capital flows from abroad. The result of this rather gradual liberalization process was that crises were avoided.

Professor McKinnon then looks at Taiwan, which since 1960 has promoted real financial