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# The EEC Association Policy

by Professor Gustav Schachter, Boston\*

Since 1964 representatives of less developed countries gather routinely every four years under the aegis of UNCTAD to tell the wealthy nations that they are unhappy about their unending poverty. Then they issue solemn resolutions to which wealthy nations pay little attention or else give lip service approval but matters do not change much from one UNCTAD meeting to another.

Countries of the group that are also Common Market Associates are in an even more difficult position. Allegedly they receive preferential treatment from the wealthy EEC countries and as such they are in an enviable position vis-à-vis other poor UNCTAD countries. Poor countries feel that they are discriminated against with regard to the special trade relationship of the EEC associate countries; and therefore in double jeopardy by a lower-lower position in the international exchange of goods. They claim that they must not only struggle to overcome the development gap vis-à-vis the more advanced nations but that they bear the brunt of discrimination that favors other poor countries, the EEC associates.

The trade advantages of the EEC associates are inflated out of reality. Each EEC associate country represents an amount of trade less than an average sized EEC city. The integration of many French speaking African countries with EEC presents some advantages but even more disadvantages. Integration is beneficial only when trade creation is larger than trade diver-

sion. EEC associate countries are by and large subsistence economies. Their cash crops are narrow-limited in agriculture to groundnuts, coffee, cotton, and oil-palm products and in mining to phosphates and iron ore. Their industrialization process is uneven from one country to another and it has been moving at a very slow pace. Moreover, the capacity use of existing plants has been about 50 p. c. In the Ivory Coast, Upper Volta and Niger, capacity used in some food and chemical plants does not exceed 30 p. c.<sup>1</sup> In most cases the domestic and African market is too narrow and EEC associate countries' industries are not competitive with their counterparts in the EEC itself. The open economy created by tariff removals that appears to be so advantageous for poor countries might contain the seeds of structural stagnation. One might just recall that Great Britain at its apex in the early 19th century strongly advocated free trade which at the time enriched Great Britain and no one else.

## Development in Open Economies

Historical evidence in less developed areas also demonstrates that market forces alone *will not* close international disparity of economic growth within an open economy. The perpetuation of backwardness in the less developed areas is due to a one way movement of resources: from the poor to the rich.

<sup>1</sup> Tableau des Industries de Consommation Locale en Afrique Noire (Situation et Projets), Bulletin de l'Afrique Noire, No. 506, Paris, May 1, 1968.

It seems that, within the same economic system, an area left economically behind can never reach a sustained process of development unless adequate measures are taken to counterbalance the advantages of the more advanced areas. In other words, *deliberate* and uneven policies for development of the poor EEC associates are needed to stop the process of spontaneous polarization in the EEC itself. Indeed there is a growing consensus among economists that a coordinated effort is required to achieve an accelerated increase in output and employment in these underdeveloped countries.

There is no easy solution for achieving sustained growth in any poor country. What poor countries at UNCTAD III conference demand now, has in large part already been granted by the EEC to its African associates with meager results. Besides an increase in direct financial aid, at UNCTAD III it has been proposed non-reciprocal preferences for less developed countries and the use of the Special Drawing Rights (SDRs) for raising aid.

The monetary crisis that set in last year affected relatively more LDCs than wealthy nations but EEC associates were less affected than LDCs in general. Most LDCs have dollar reserves but EEC associates have Franc reserves and the Franc was not devalued. It appears that over the last year LDCs lost about 1 bn dollars in reserves because of the international financial crisis. They suffered a setback in their capacity to accumulate

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foreign exchange and procure the capital they need. This is why poor countries demand representation to the "Club of Ten" as an aggrieved party. Within this context UNCTAD III proposed the expansion of SDRs' use.

### Expansion of SDRs

Some economists contend that expanding SDRs' use so that poor countries can have more cheap credit would first be highly inflationary and second would induce aid-donor countries to cut their aid commensurately. The SDRs as fiat money can induce inflationary pressure when used by rich as well as poor countries. Assuming that donor countries would cut their aid commensurately to the SDRs to the LDCs receiving SDRs, it would still be worthwhile for poor countries vis-à-vis bilateral aid. Bilateral aid is usually tied-in to the donor countries — the poor countries must often purchase goods at higher prices than they would if they had a choice of suppliers. The SDRs are similar to the multinational aid approach. The LDC can shop around and purchase goods from the lowest bidder. Perhaps this is the main reason why rich countries object to such an agreement that would loosen their control over the aid receiving country. Indeed, if wealthy nations would be ready to enter into a general non-reciprocal preferential agreement, poor nations as a *whole* would be helped but, then, cut-throat competition would develop among poor nations. Demand for primary goods is inelastic; expanded production would just increase the supply of these goods thereby inducing an across the board decline in prices and poor countries' foreign exchange revenue. With regard to manufactured goods, poor countries cannot compete with more developed countries because usu-

ally their productivity and marketing sophistication is far below those of developed countries.

Rich countries have not easily accepted non-reciprocal preferences. Where tariffs have been eliminated, other impediments have been introduced such as special licenses, stricter sanitary requirements and above all quotas. The use of quotas is a stronger barrier to trade than tariffs even when an annually "expanded" formula is allowed. It limits bilateral trade and obviously discourages multilateral trade. To be sure, as former colonies, the EEC associate countries are still locked in by trade patterns developed under their colonial masters. Not only trade patterns and trade relationships but also production patterns have remained the same after achieving independence. Even now France is by far the most important trade partner to its former colonies though the same trade regulations exist for all EEC countries.

These countries have dual economies composed of a small modern industrial enclave tucked away in a large traditional agricultural sector. Usually the traditional sector caters to domestic use and to a lesser extent to exports. Some economists contend that the size and the strength of the export-directed sector determines development. Yet, over the last decade those associated countries with strong export-oriented sectors did not necessarily achieve conditions of development. These exports consist usually of agricultural (plantation) products or subsoil raw materials. As exports, these sectors have no forward linkages (output is not used for domestic production of other goods) and as primary products they have no strong backward linkages (very few of the outputs of other sectors are needed for production in primary sectors.) It is well known that link-

ages are a key ingredient for achieving economic growth if not development. Backward linkages are propelled by those sectors that use many domestic inputs at various stages of production.

### Restructuring of Import Promotion

The only way to achieve structural change in EEC associated countries — benefiting from the association but not necessarily hurting other less developed areas — rests upon removal of quotas but even more upon redirecting the type of goods EEC countries would be willing to purchase. Import promotion needs to be changed from raw materials to semi- and manufactured goods. Instead of importation of coffee beans, imports of instant coffee should be encouraged; instead of cocoa, cocoa butter; instead of cotton, cotton fiber and cloth. The change in the pattern of imports would allow structural changes in the associated countries with increased employment and decreased needs for aid. But also because of increased income and foreign exchange availability, associate EEC countries (and other LDCs whenever they are given the same preferences) would be able to purchase more goods produced by capital intensive industries in the EEC.

The EEC countries complain and will continue to complain that such an arrangement destroys most of their own labor-intensive industries. No one denies this. But in open economies, as created by the association of poor African countries with the overindustrialized European Community countries, if regional specialization is not allowed to develop, the entire integration process is a sham. Development cannot occur without structural change. As long as the associated countries con-

tinue to export their primary goods (and this with limitations) and cannot export processed goods because of noncompetitiveness or hidden trade barriers, no structural change is possible. In short, structural change is needed not only for the poor areas but also for the developed areas because obviously the latter must change their economies in order to absorb the processed goods ready to be delivered by the poor African associates.

### Overrated Trade Preferences

Indeed, this is the prescription for the world — said in different ways — that emanated from the three UNCTAD conferences. But the UNCTAD conferences are strongly against having such solutions applied only among restricted groups, such as the EEC and its associates. They claim that such regional arrangements would discriminate against everyone else — this was pronounced illegal even in terms of GATT's rules. The reality is that since the Yaoundé agreement, the preferences granted by EEC to its associates did not change existing trade patterns. In fact, between 1958 and 1969, the EEC imports from all LDCs increased by 108 p. c., but from associated members and North Africa by only 88 p. c. During the same period the EEC's total trade with non-associated LDCs in Africa increased at 6.8 p. c. annual rate and by 5.6 p. c. with EEC's associates.

The associates' trade represents a miniscule fraction of all trade and only a small fraction of trade in primary commodities. Just competing in primary commodities would not bring about conditions of development because the tendency to concentrate in one or a few products such as certain agricultural or mining products makes these countries vulnerable to inter-

national price and demand fluctuations. Countries that produce for export mainly groundnuts, sugar, or iron ore have no elbow room. They must compete with other countries in the same line. Vagaries of weather but also of international politics greatly affect how much and at what price such products are sold if at all. The dependence of Senegal and Mauritania on iron ore is the best example of struggling one export-commodity poor countries.

### Declining Terms of Trade

It is generally acknowledged that poor countries have unfavorable "terms of trade". When the price of groundnuts is 10 c per lb. and the price of a tractor is \$ 20,000, it takes 200,000 lbs (100 tons) of groundnuts to buy one tractor, but when the price goes down to 5 c, twice as much groundnuts (200 tons) is required to buy one tractor. Some economists, notably Raúl Prebisch, claim that the terms of trade have deteriorated for poor countries over the last twenty years.

International prices are set through the interaction of demand and supply according to the price elasticities. Demand for primary products is quite inelastic but so is the supply. With more elastic demand or supply with respect to price less change in total revenue for a change in supply would occur. This is one of the reasons why the UNCTAD conferences attacked the EEC regional arrangements. But more inclusive arrangements would induce larger entry into the market and decrease the revenue for *all* primary producing countries. Rationing or international planning (as suggested by Raúl Prebisch) could solve this problem but few countries are ready to adopt it.

Prices of manufactured goods imported by poor countries do not behave alike. They are usually controlled by a few firms and the supply is not affected

greatly by whether or not new firms enter the market. Therefore any time the supply of commodities is restricted, poor countries have to pay more for manufactured goods in terms of primary exported products; no wonder as reported by the EEC April 1972 News Bulletin, "... the developing countries have experienced both a decline in terms of trade and a reduction of their world market share. On the economic level, their external debts assumed such proportions that interest payments alone eat up most of their foreign aid revenue."

The discussion of UNCTAD III, the implementation of the New Yaoundé Agreement and the new financial crisis propelled by the devaluation of the British pound demand new approaches for relationships between industrialized and poor nations in general and between EEC and its associates especially:

### New Approaches

- ☐ Escape clauses in non-reciprocal preferential agreements must be eliminated.
- ☐ Importation of semi- or manufactured labor-intensive goods by EEC should be encouraged.
- ☐ SDRs could be extended as an instrument of aid; thus, bilateral aid would be replaced by multilateral aid.
- ☐ LDCs that are hurt by the instability of international financial markets should get better representation at IMF or in the case of EEC associates (more realistically) at the European Development Bank (EDB).

Only through these onesided measures, difficulties encountered by LDCs in open economies can be mitigated if not completely eliminated. The progress of LDCs will further enhance effective demand which, in the long run, will benefit both poor and rich countries.