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GATT and UNCTAD – Development Theory and Practice

by Dr Günter Heiduk, Aachen *

Inherent in this subject is the question of foreign trade: Does it help or hinder development of LDCs or, more concretely, under what conditions and by what measures can positive effects be achieved and negative results be avoided? ¹

The economic and especially the trade political problems of the less developed countries have for years been in the foreground of international discussions. Ever since World War II, international trade has been rapidly rising.² This was primarily due to a large expansion of trade between the industrial countries. In absolute terms, the LDCs were also able to increase their trade, but their share in world trade has been steadily dwindling, falling from 32 p.c. in 1950 to 17.1 p.c. in 1972. In the light of this unfavourable trend, the view is held in many LDCs that the advantages of foreign trade accrue primarily to the industrial nations. Moreover, there are many people who maintain that the foreign trade system as conceived by the free-trade countries and also by GATT (General Agreement on Tariffs and Trade) contributes nothing or not enough to the development of the economically backward regions of the world. The main target of these criticisms is in fact GATT which exists since 1947³. This agreement is felt in theory and practice to benefit primarily the trade of industrial nations.

In 1962, the Economic and Social Council of the UN decided to call a trade and development conference which met two years later in Geneva. In the same year – 1964 – the General Assembly of the UN agreed to a proposal by the Geneva Conference that it should be given the status of an organ of the General Assembly. Thus the “United Nations Conference on Trade and Development” (UNCTAD)⁴ was born. The reason for the establishment of this organisation was that an institution

with a worldwide membership was necessary to cope with the problems of international trade⁵. UNCTAD was given the task of promoting international trade, particularly from the point of view of helping economic development. Today, UNCTAD's sphere of activity embraces all the economic problems of the LDCs, thus extending far beyond its original brief.

The Regulating Principles of GATT

GATT is to contribute to the raising of living standards of its members. This is to be achieved by substantial reductions in customs duties and other trade barriers as well as by the removal of discriminatory foreign trade practices⁶. The policy pursued by GATT aims at achieving the highest possible degree of free trade by:

- ☐ granting tariff concessions on entry into GATT;
- ☐ holding “tariff rounds” of all members from time to time;
- ☐ banning in principle all quantitative import restrictions;
- ☐ according equal status to home and foreign products as far as internal levies and legal provisions are concerned;
- ☐ the removal of obstacles to trade other than tariffs;
- ☐ discussing the possibility of anti-dumping duties.

Technical regulations are to ensure that all agreements entered into are given their maximum effect. Negotiations are conducted on a bilateral basis in accordance with the so-called “chief-supplier rule”, which means that the main consumer country of a particular product discusses with the main producing country what can be done to liberalise trade

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¹ The present article is based on the book by its author, G. Heiduk, *Die weltwirtschaftlichen Ordnungsprinzipien von GATT und UNCTAD – Instrumente der Entwicklungspolitik* (GATT's and UNCTAD's Regulative Principles for a World Economy), Baden-Baden, 1973, chapters 2 and 3, pp. 73.

² In 1950, the volume of world trade represented a value of \$ 115.3 bn.; by 1972 it had risen to \$ 825.9 bn.

³ GATT embodies the trade-political aims of the Havana-Charter seeking to revive world trade by way of establishing a regulative system which promotes free trade.

⁴ The Conference is supposed to meet at least once every three years. In fact, three full-scale meetings have taken place since its establishment.

⁵ GATT has 80 members; UNCTAD III, which met in Santiago de Chile from April 13, 1972 until May 21, 1972, was attended by representatives of 142 countries.

⁶ Cf. Preamble of GATT, printed in: K. W. D a m, *Law and International Economic Organization*, Chicago and London, 1970, p. 391.

in that product. According to the principle of the "General Most-Favoured-Nations Treatment" any bilaterally agreed concessions must be extended without delay or qualifications to all commodities of the same kind coming from other member states. This provision ensures the extension of any liberalising bilateral agreement to all member states.

The provisions of GATT allow however certain exceptions to this general principle of free trade in that, according to Article XXXVI, paragraph 6, LDCs are absolved from the obligation to grant industrial countries anything in return for the tariff and non-tariff concessions they have obtained from them.

The Regulative Principles of UNCTAD

The Secretary General of UNCTAD I, Raúl Prebisch, submitted in 1964 a report⁷, which formed the basis of the trade-political recommendations of UNCTAD. That report recommended the conclusion of further raw material agreements, the granting of tariff preferences by the industrial nations to LDCs within the framework of GATT as well as the establishment of a new world trade organisation.

UNCTAD would like to see world trade as an instrument to promote growth in the LDCs. It seeks to shape international trade in such a manner that it ensures a rapid increase in the export revenues of LDCs. To achieve this objective, UNCTAD has passed a number of resolutions, recommending inter alia:

- ☐ that the developed countries adjust their economic structures in such a manner as to give LDCs a better chance to sell their products;
- ☐ that the industrial nations concede to the LDCs a privileged position, in particular by granting their products unimpeded access to their markets without any return;
- ☐ that the industrial countries exercise restraint in supporting their home producers of raw materials so as to enable LDCs to obtain a fair share of the market at worthwhile prices;
- ☐ that the negative effects of substitution of products from LDCs be kept within reasonable limits;
- ☐ that the losses suffered by LDCs through deterioration of their terms of trade be made good.

UNCTAD has hitherto devoted much attention to international raw material problems. With a view to expanding and stabilising these markets, it has recommended a whole range of measures, which largely tackle the problem from the production end. Among these recommendations are: quota agree-

ments, maximum price fluctuations and guaranteed minimum import quantities. The prices of raw material exports should move in line with those of imported finished products so as to ensure that the LDCs' purchasing power available for the acquisition of imports remains constant. Numerous new raw material agreements should be concluded on lines similar to those already in force for cocoa and sugar.

GATT and "Vent-for-Surplus"

According to "classical" theories, international trade is of advantage to countries participating in it, if the goods exchanged vary in cost either absolutely or relatively. These cost variations are due to differences in the availability of production factors or to varying degrees of productivity. The lower the trade barriers, the more effective these advantages tend to be.

In trade exchanges between LDCs and industrial countries it is not so much the differences in costs as the surplus availability of production factors ("vent-for-surplus" theory) that matters and the productivity-increasing effects of the exchange of goods (productivity theory).

For our present purposes the "vent-for-surplus"⁸ theory is particularly applicable in that it assumes that the goods produced in two countries are not identical, that the available production factors are not fully employed and that the factors are immobile, i.e. that they cannot be transferred abroad. Trading with other countries makes it possible for hitherto unused output capacities to be utilised. In such circumstances the export of goods creates additional employment at home while at the same time increasing productivity. These two effects combined produce in turn a rise in national income. If the additional income is spent on imports, more goods become available on the home market, and that *without* the production of other goods being in any way reduced. The surplus capacities in the LDCs are due to a disequilibrium between potential production and potential consumption. The national markets are too small to absorb supplies. Moreover, domestic production is widespread, which further diminishes the effective demand on the market. Importing industrial products is more advantageous than producing them internally because the necessary production factors are frequently not available in the required quantity and quality and because home demand is too small to support production units of a competitive size.

For growth to be achieved in LDCs through the stimulation of exports, it is however important that

⁷ UNCTAD, Towards a New Trade Policy for Development - Report by the Secretary-General of the UNCTAD, E/CONF. 46/3, February 12, 1964.

⁸ Cf. H. Myint, The "Classical Theory" of International Trade and the Underdeveloped Countries, In: The Economic Journal, Vol. 68 (1958), pp. 317; also: G. M. Meier: The International Economics of Development - Theory and Policy, New York, Evenston, London 1968, pp. 214.

improvements are brought about, not only in the allocation of production factors, but also by making existing production functions more effective? Dynamic gains in the foreign trade position depend on changes in the proportion of the relevant production factors, technical progress, changes in labour productivity, increases or reductions in real incomes, changes in consumer preferences and shifts in the price relations between various goods. According to how these factors are concerted, the result will be neutral, positive, strongly positive, negative or strongly negative as far as a country's foreign trade is concerned. For LDCs the effects are highly likely to be positive, if not strongly positive. Practical experience has shown that in many LDCs exports have increased at a faster rate than the GNP. This is mainly due to three reasons: firstly, it costs relatively less to import the capital goods required by the export industries; secondly, the opening up of international markets makes it possible to use existing output capacities more economically; and, thirdly, foreign investments bring with them a transfer of technological know-how which improves the quality level of the production factors.

Viewed in this light, a liberal economic order such as GATT is seeking to establish is to the LDCs' advantage. Questionable is merely whether the gains achieved by the LDCs in the field of foreign trade will automatically lead to overall economic growth. "Classical" theory assumes that "gains from trade" and "gains from growth" are identical – an assumption, which is not necessarily valid in the case of LDCs. Dualistic economic structures prevent the "carryover" from foreign trade to the economy as a whole. An important precondition for the success of an export-led economic growth is therefore the creation of sectoral and spatial interdependencies.

Secular Deterioration of the Terms of Trade

R. Prebisch¹⁰ in his "Theorie der peripheren Wirtschaft" comes to the conclusion that in present circumstances LDCs derive no benefit from foreign trade. Basing on his empirical researches, Prebisch believes to have proved that the terms of trade have for a long time been moving against the LDCs. In support of his thesis he points to:

□ the relatively small supply, demand and income elasticity of exports from LDCs compared to those of industrial countries;

□ the unfavourable effects on underdeveloped regions of their dependence on cyclical developments in industrial countries;

□ the inadequate transfer of technical advances from industrial nations to LDCs.

Unhampered foreign trade leads to a deterioration in factor allocation and thus to a reduction in the incomes of LDCs because increasing exports can be sold only at lower prices and because additional production factors are used in a sector in which the level of output is relatively lower.

The long-term trend towards a deterioration in the terms of trade means, according to Prebisch, that LDCs trading with industrial nations are obliged to put up with losses of income in that some of their income is transferred to the industrial nations. The relatively small increases in productivity of LDCs are reflected in falling prices, which their weak bargaining position forces them to accept. On the other hand, the industrial nations for their part do not pass on the benefits of their relatively greater productivity increases in the form of lower prices because, for a variety of reasons, (for example the power of the trade unions) their prices are not flexible in a downward direction. In these circumstances the LDCs must spend a greater part of their income on imports than the industrial countries. Whereas industrial nations derive from their exports some sort of rent, the LDCs in exporting transfer part of their income to them.

Thus LDCs can achieve equilibrium only if they keep foreign trade to a level lower than it would be if trade were entirely free. Such a reduction makes it possible to distribute the labour force over various sectors¹¹ in such a manner that the marginal income in all sectors is equal.

Prebisch's theory is not universally accepted. He is primarily criticised for maintaining that a deterioration in the terms of trade is tantamount to a growth impeding effect. There are also doubts about the statistical concept underlying his empirical researches. Other empirical studies¹² have been unable to confirm that there is in fact a secular deterioration in the terms of trade of the LDCs.

Apart from Prebisch's theory, there is another theory which has also been widely discussed – the so-called "Gap" theory¹³. Investments are essential, if an LDC is to increase its income. Investments can only come in the form of imports. More foreign exchange is needed to pay for imports than

¹⁰ For "production theory" see: G. M. Meier, *The International Economics of Development*, op. cit., pp. 20; also: H. G. Johnson, *Economic Development and International Trade*, in: *Money, Trade and Economic Growth*, London 1962, pp. 75.

¹¹ R. Prebisch, *Commercial Policies in the Underdeveloped Countries*, in: *The American Economic Review, Papers and Proceedings*, Vol. 49 (1959), pp. 251; and by the same author, *The Economic Development of Latin America and Its Problems*, in: *Economic Bulletin for Latin America*, Vol. 7 (February 1962) pp. 1.

¹² R. Prebisch distinguishes only between two sectors: the agrarian (export-) and the industrial sector.

¹³ Cf. P. T. Ellsworth, *The Terms of Trade between Primary Producing and Industrial Countries*, in: *Inter-American Economic Affairs*, Vol. 10 (1956), pp. 47; also: B. M. Bhatia, *Terms of Trade and Economic Development: A Case Study of India – 1861–1939*, in: *The Economic Journal*, Vol. 16 (1969), pp. 382.

¹⁴ Cf. S. B. Linder, *Trade and Trade Policy for Development*, London, 1967, pp. 42.

is received for exports. This foreign exchange gap can only be filled by restricting imports. The external equilibrium produces however an internal disequilibrium. Potential increases in income cannot be realised for the simple reason that lack of foreign currency prevents the import of the necessary capital goods.

UNCTAD's demand for *tariff preferences* to be granted to LDCs is contrary to the general liberalisation of international trade which GATT is aiming at. Tariff preferences, provided they lead to a switch of production or consumption from high-cost to low-cost suppliers, enable the countries concerned to increase their prosperity through a more efficient use of their resources. If the supply of low-cost products increases, one speaks of a positive production effect; if demand switches from the more expensive to the cheaper product, one calls this a positive consumption effect. The apportionment of gains and losses to the individual countries is measured by the terms-of-trade effect. The LDCs, which obtain preferential treatment, could increase their exports at the expense of exports from third countries; if they do, they receive a "windfall gain"¹⁴ equivalent to the extent of the tariff preference. Besides, increased output in LDCs may also lead to increasing returns to scale. Internal economies result from the increasing specialisation of the production factors and technical improvements in the production plants. These internal economies represent external economies for the preceding and the succeeding stages of the production process.

Whether the effects expected of a preferential system do in fact materialise and whether the LDCs actually profit by them, is open to question. Even if one accepts that in an LDC investments may be expected to yield especially high returns because possibilities of achieving internal economies do exist but have not yet been exploited¹⁵, there is still room for scepticism.

B. Balassa has calculated that, at the conclusion of the Kennedy-Round, average nominal tariffs on manufactured imports from LDCs amounted to 11.8 p.c.¹⁶ A study carried out by G. Patterson comes to the conclusion that with a preference of 50 p.c. on an average customs duty of 10 p.c. only a very few of the industries in the LDCs are competitive¹⁷. According to H. G. Johnson, on the other hand, preferences will lower the remaining tariff barriers sufficiently to allow the export of finished goods to increase strongly¹⁸. In the short run, however, the LDCs will hardly be in a position to take advan-

tage of these new export possibilities. The scope for preferential treatment will gradually be lost as liberalisation through GATT progresses. A system of preferences will only prove its value, if the exports from LDCs remain competitive after all tariffs have been completely abolished. To determine in advance, which products will be able to compete, is wellnigh impossible. Besides, the LDCs are demanding, not a selective system, but one that guarantees them a one-way free trade. There is a danger that this may lead to the creation of export industries which in the long run will not be competitive. Such misdirections of resources are much less likely to occur, if tariffs are lowered allround and not only those of the industrial countries.

Raw Material Agreements and More Efficient Distribution

International *raw material agreements* are useful for development policy when economically not justifiable quantitative and price fluctuations are causing marked short-term changes in export revenues of LDCs. On the other hand, no agreement has so far been able to achieve price stability over a longer period, mainly because they are not equipped to tackle the root causes of price fluctuations. Now, price stabilisation in the sense that UNCTAD demands it means price increases over and above world market levels. This is a form of "hidden development aid" which carries with it no guarantee for a more efficient distribution. Prices, which do not conform to market conditions and are too high, prevent the elimination of marginal suppliers and offer new incentives to producers, which tends to depress prices. They prop up unprofitable production, sensible structural changes in the interests of economic development are left undone; i. e., development potential is being wasted. If, by contrast, raw material markets are liberalised, only suppliers whose costs are lowest stay in the race and capacities can be released for more productive purposes.

Thus two contrasting principles confront each other — the free-trade principle of GATT and the interventionist dirigisme of UNCTAD. In the longer run, UNCTAD's concept is relatively the more dangerous than GATT's free-trade principle in that it encourages the misdirection of resources. On the other hand, with free trade the LDCs would initially be facing problems of adjustment which they could hardly be expected to solve unaided. From a development-political point of view therefore, it would seem sensible to apply the two principles in combination.

¹⁴ H. G. Johnson, *Economic Policies Toward Less Developed Countries*, 2nd printing, Washington, 1968, p. 187.

¹⁵ Cf. T. Scitovsky, *Two Concepts of External Economies*, in: *The Journal of Political Economy*, Vol. 62 (1954), p. 143.

¹⁶ B. Balassa, *Tariff Protection in Industrial Countries: An Evaluation*, in: *The Journal of Political Economy*, Vol. 73 (1965), p. 573.

¹⁷ G. Patterson, *Would Tariff Preferences Help Economic Development?*, in: *Lloyds Bank Review*, April 1965.

¹⁸ H. G. Johnson, *Präferenzen — ein wirksames Instrument der Entwicklungsförderung*, (Preferences — an Efficient Instrument of Promoting Development), in: *WIRTSCHAFTSDIENST*, Vol. 46 (1968) pp. 374/375.