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# External Economic Policy and Development Policy

by Axel Borrmann, Hamburg \*

Since 1970 the world economy has gone through a series of grave crises which have stimulated an intensive discussion about the economic and political relations between industrialized and developing countries. As seen from the Federal Republic of Germany, the witnessed events have not only an international dimension, but they focus attention again on one particular problem of national economic policy, the relationship of external economic policy and development policy, because the new strains on the international plane are in part reflected by this relationship.

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The two spheres of external economic policy and development policy are in many ways objectively interdependent and therefore very closely interrelated. In consequence of this they may overlap and clash. An attempt will be made here to analyse systematically how these two spheres of policy are related and to identify those associations between them which may give rise to conflicts. Finally, the conditions and prospects for success in efforts to remove or lessen the identified conflicts will be discussed.

## Development Effects of External Economic Measures

The external economic objectives of the Federal Republic of Germany, which have their place in the common setting of the external economic policy of the European Community, include the demand for a trade policy towards other states which ensures freedom of trade and factor movements. International division of labour and structural changes are indispensable prerequisites to and subsidiary aims of it.

The Federal Republic engages in development policy in order to promote the economic and social progress of the developing countries in a system of global partnership. On the economic plane it aims at creating, in the interest of both sides, the preconditions for more extensive exchanges of goods. More intensive integration of the developing countries with world trade through improvement of their sales opportunities is a major objective.

Of the instruments employed in pursuit of external economic objectives those used for the trade, raw material and monetary policy are of

special interest for development policy. The German *trade policy* forms part of the foreign trade policy of the European Community. In the setting of its external economic policy it continues to be one of the stated aims of the Federal Republic that it wishes to pursue a trade policy towards foreign countries which is based on the principle of unrestricted imports and exports. An analysis of its trade policy towards the developing countries reveals a large measure of compatibility as far as the objectives of both sides are concerned because trade liberalization and opening-up of markets are in accord with the interest of the developing countries in an improvement of their economic and social conditions through greater integration with the world economy.

As regards the instruments to be used in pursuit of these aims there is however a possibility of more or less severe conflicts developing in some foreign trade sections. The Common Agricultural Policy and tariff obstacles — some of which provide a substantial measure of protection — shield many markets, also in the Federal Republic of Germany, from competition by third countries. The non-tariff obstacles to trade, which seem to have superseded the classical instruments of trade policy in certain areas, are no less effective in this respect.

The general trade policy towards third countries has been modified in regard to its application to developing countries. Owing to the trend towards integration it now originates less and less from a wish for national autonomy in matters of economic policy. Since the introduction of a system of generalized preferences and the Lomé Convention the imports from developing countries have been enjoying a preferential treatment which may be regarded as the most important contribu-

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tion yet by western industrialized nations to trade liberalization. Nevertheless these measures did not and do not suffice to free completely the imports from developing countries from the obstacles seen to operate in certain sectors.

In the area of the agricultural products which are regulated by Market Orders there is still a potential for conflicts although the resulting negative effects are as a rule dispersed over a large number of developing countries. The imports of raw materials from developing countries are not impeded by major obstacles because the Federal Republic is one of the countries which depend upon imports – for some categories of goods to a substantial degree. In the area of finished and semi-finished industrial products the developing countries had until a few years ago to put up with considerable competitive handicaps arising from the numerous tariff and non-tariff obstacles, and this in regard to goods in the production of which they enjoy special advantages (as in the case of labour-intensive products). The preference system has probably removed part of the protection, and the Lomé Convention operates for a limited number of favoured states in the same direction. The conflict between external economic policy and development policy is nevertheless likely to drag on – though it is less acute now than some years ago – because the system of tariff preferences suffers from weaknesses, especially the quota system and other ongoing non-tariff obstacles to trade.

As a country with few raw materials the Federal Republic is dependent on imports *inter alia* for its mineral oils, rubber, timber, wool, iron ore, non-ferrous metals and other commodities. In spite of this it has not yet defined general objectives for its *raw material policy*. Such aims and measures as have become known relate only to a few commodity sectors (agricultural products, mineral oils, crude minerals). In regard to these no consideration has been given to development policy as an aspect of raw material policy. The aims of the latter however are not in conflict with the normative ideas of development policy. The two could therefore come into conflict only when measures for the supply of raw materials are worked out in detail. The enlargement by the Federal Republic of its own raw material basis for instance could have repercussions on the export earnings of the developing countries; stock-piling of commodities by the state could have short-term effects on the prices. Besides, supplying and consuming countries may not always think alike about the direction in which production and export patterns should be diversified in a particular developing country, and this could lead to conflicts even with long-term supply con-

tracts. Since the interpretation of the right of developing countries to dispose of their natural resources is a contentious issue, strains may be set up if the promotion of direct investments for reasons of raw material policy clashes with the recognition of the mentioned right on grounds of development policy. Finally, conflicts could threaten if the development aid were accommodated to the requirements of raw material policy.

These fields of tension are however only potentially areas of conflict. Over large areas it seems to be possible to gear measures which are advisable in the interest of external economic policy to the objectives of development policy and thus to lessen the danger of conflicts, the more so because the raw material interests of the Federal Republic and the developing countries are interdependent.

Since the Federal Republic of Germany is at present the most important trading partner of the developing countries after the USA and Japan and its economic relations with them are marked by an – in some cases pronounced and one-sided – dependence of the developing countries upon the foreign trade with the Federal Republic, *monetary measures* are assuming special importance for their long-term growth prospects. Their objec-

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tives do not in general clash with external economic policy aims, but there may be conflicts, of varying intensity, between interrelated monetary instruments and development policy objectives.

Because of the intrinsic uncertainties of floating exchange rates and the increased need for structural adjustments, a more flexible exchange rate policy, as pursued by the Federal Republic in recent years, may hamper development planning and financing in the developing countries. Moreover, it cannot be ruled out that negative effects of D-mark revaluations depress the purchasing power of export earnings, tend to increase the debt burden and lower the real value of the currency reserves of the developing countries. It is probable that only a few developing countries – those whose foreign trade pattern bears an especially favourable relation to the import demand of the Federal Republic – derive partial compensation for these negative effects from positive price and volume repercussions on the export earnings position in consequence of a D-mark revaluation. As far as the majority of developing countries is concerned, such positive effects are not likely. It has to be borne in mind of course that an exchange rate adjustment by the Federal Republic only eliminates external economic advantages and does not necessarily create disadvantages.

#### **Effects of Development Measures on External Economic Policy**

One of the most important instruments employed in German development policy is *capital aid*. The provision of capital aid means for the Federal Republic of Germany in the short run that the demand for consumption and/or investment is reduced: the demand thus first suffers a shortfall. For the longer term the prospect is different because the capital aid enlarges the import capacity of the developing countries. The Federal Republic is in this respect in an especially advantageous position because its export industry has a bent towards investment goods. That this capital aid is largely "un-tied" makes little difference. Hence such capital aid imposes only a temporary and partial burden on the balance of payments as capital exports of this kind are succeeded by exports of goods and services which have the opposite effect on the balance of payments. The growth effects are however in total still relatively small because the capital aid currently amounts to no more than 0.23 p.c. (1973) of the economic demand as a whole. The effect on the balance of payments is likewise of little significance under external economic aspects. It can therefore be concluded that, taking an overall view, capital aid does not come into conflict with the objectives of external economic policy.

The capital aid can however strengthen the export potential of the developing countries in the long run and enable them to compete increasingly as suppliers for the markets of the industrialized countries. A conflict between capital aid and external economic policy would in this case be avoidable only if the industrialized countries were ready to open their markets, thereby promoting growth, and to adapt their internal economic policies to a process of structural change.

The *promotion of the utilization of raw materials* in the developing countries is recognized as a sectional objective in the compass of the development policy of the Federal Republic. The utilization of natural resources of the developing countries is being encouraged by commodity agreements and measures for the processing of raw materials as part of the diversification of their production structures, in addition to general measures for the promotion of development.

An analysis of the *commodity agreements* shows that they are primarily inspired by development policy although considerations bearing on the supplies for the industrialized countries are a factor. From a viewpoint based on the principle of free trade the commodity agreements must be regarded as a violation of the basic principle of a liberal foreign trade policy. A less formal view of these agreements shows however that they can contribute positively to – under development and external economic policy aspects meaningful – market regulation. From the viewpoint of external economic policy commodity agreements may be regarded as instruments for the safeguarding of raw material supplies at stable prices. Considering however the small number of commodity agreements concluded so far and their practical weaknesses their effectiveness under external economic aspects must be assessed as relatively small.

The extension and *diversification* of the structure of production is an objective of the development policy of the Federal Republic. In the case of products with a high raw material and labour content many developing countries are enjoying locational cost advantages compared with producers in more highly developed countries. The expansion of the exports of such products conforms in principle with the external economic policy of the Federal Republic. It makes for an intensification of the international division of labour, improves the allocation of resources through structural adjustments and creates fresh scope for growth. If the demand for imported goods rises in the developing countries as a result of higher incomes, this effect will be reinforced. Negative effects on employment must

however be anticipated during the structural adjustment process although encouragement of the processing of raw materials on grounds of development policy is basically compatible with the objectives of external economic policy.

The *encouragement of private direct investments* serves the purpose of removing or reducing obstacles to investment which make private commercial commitments in developing countries difficult or impossible. Private direct investments are, irrespective of any encouragement by the state, in accord with the international division of labour, a precept of external economic policy, and the aim of maximum mobility of the production factors following from it.

An analysis of the priority rating given by businessmen to the promotion instruments employed by the state in their investment calculations shows to what extent external economic effects really spring from such measures of state support. Empirical studies have shown that as a motive for business commitments in developing countries promotion measures play only a subordinate part; rarely are they the spur for an investment. It follows that promotion by the state is only in a very restricted sense the cause of private direct investments in developing countries with possible external economic effects (negative for the balance of payments for instance if capital is exported, and positive if trade flows are induced by investments and revenues).

### Results

It emerges clearly from the analysis of the related objectives of external economic policy and development policy that the aim of an integrated world economy and international division of labour has been in the past, and may be in the future, a crystallization point for conflicts between the two spheres of policy. The relationship revealed by the detailed analyses is significant insofar as the formal juxtaposition of the encountered objectives of external economic policy and development policy does not show them to be essentially opposed to each other. The exceptional importance of embracing the national economy in a global economy with international division of labour is emphasized in both these spheres of economic policy for reasons of their own. The empirical analysis has nevertheless revealed that a large number of existing interdependences between the most varied instruments of economic policy have a bearing on these objectives and that relations of potential conflict do exist. The harmonization of trade policy and development policy and the realization of their common aim of division of labour in the world

economy therefore appear to be among the cardinal problems concerning the relationship of external economic policy and development policy.

The developing countries cannot regard the present state of division of labour with the Federal Republic as satisfactory. Complementary goods exchanges continue to dominate. The developing countries have evidently not gained the hoped-for access to German markets for the processed products which are to be the principal means of closing the financial gap between import requirements and inadequate revenues from the exports of primary commodities. It is however impossible for them to increase their foreign currency incomes except by producing and exporting products with a high labour and raw material content. The competitiveness of products of this kind which are still produced on a major scale in industrialized countries seems to be due to artificial stimulation.

This trade protection seems to have been lessened to some extent by the trade preferences granted in the meantime to imports from developing countries by the European Communities. The many reservations and exemptions from the generalized preference system however suggest that the propensity for liberalization is greatest where the export interests of the developing countries conflict least with the producing interests of the Community countries. Protection is likely to remain a reality, especially as a result of continuing quantitative and non-tariff restrictions on competing products.

This ongoing conflict between the external economic policy and the development policy can be eliminated only in part by the Federal Republic. As far as the use of the classical instruments of external economic policy is concerned, the Federal Republic has largely surrendered its autonomy to the EC. The scope left to it in regard to non-tariff obstacles to trade however still offers a leverage. Available are in particular certain measures which do not primarily concern the external economic policy but have nevertheless a protectionist effect and are not subject to Community regulation. The removal of obstacles of this kind seems to be possible. In conjunction with improved preferential arrangements for imports from developing countries for which the Federal Republic could work, this would create important preconditions for gradual adjustments of the domestic production structure. The movement of production factors into more productive spheres which can be expected to impart positive impulses for the general well-being could and should be supported by the state through flanking measures.