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# Some Critical Aspects of EC Development Co-operation

by El-Shagi El-Shagi, Trier\*

**The range of instruments used by the European Community in its development co-operation with Third World countries is wide and in various respects controversial. The following article illustrates a number of aspects of EC development co-operation that have attracted criticism and makes suggestions for an efficient policy.**

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Nobody can seriously doubt that Third World countries benefit from development co-operation with the European Community. This can be seen not only from the substantial real transfers that are made, as exemplified by the fact that more than 64% of the resources distributed under the fifth tranche of the European Development Fund took the form of outright grants, but also from the transfers of technology, the inflows of private direct investment and many other indicators. Hence, despite its concentration on certain criticised aspects of the Community's development co-operation and policy towards developing countries, this article should not be interpreted as an exercise in denigration but as an attempt to highlight any shortcomings in the hope of prompting a more rational formulation of policy.

## Priority to the Rural Sector

The priority given to the promotion of agriculture and rural development under development co-operation programmes is not peculiar to the EC but is also to be encountered in other international organisations as well as national development aid agencies in various donor countries, including the Federal Republic of Germany. The promotion of agriculture was a prominent feature of EC development aid from an early date, so that it would hardly be surprising if the Community agencies responsible prided themselves on having followed a

course that is now considered correct long before the rest of the field. That is not the case, however; Community officials frankly admit that the EC's development co-operation with Third World countries lacked a true strategy until the beginning of the eighties.<sup>1</sup> The so-called Pisani Memorandum of October 1982<sup>2</sup> clarified the priorities for the first time and attempted to marshal the individual components into an all-embracing concept.<sup>3</sup>

The strategy that is now taking shape aims not only to provide more aid to promote agriculture and rural development but also within that context to shift the emphasis towards the achievement of self-sufficiency in food in Third World countries. Moreover, from the point of view of methodology it seeks to move away from the pure project approach in favour of more co-ordinated activities, which are to be harmonised through "policy dialogue" not only with the aid recipient's own efforts but also with the activities of other donors where possible. The requirement that the co-ordinated efforts concentrate largely on the areas stated above is justified mainly on the grounds that the increase in food production has been "unsatisfactory" and that many developing countries' food imports have risen. Other reasons given are the failure of attempts at

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\* University of Trier. Slightly abridged version of an address delivered at the Sixth Malente Symposium of the Draeger-Stiftung on "The Role of the European Community in the World Economy", held from 27th to 29th October 1986 in Malente, Schleswig-Holstein. This and the other contributions to the symposium will appear shortly as volume 11 in the "Zukunft" series, published by Nomos Verlag, Baden-Baden.

<sup>1</sup> See the remarks of the EC Commission's Director-General for Development, D. Frisch: Die entwicklungspolitische Konzeption der Gemeinschaft, in: F. Franzmeyer, H.J. Petersen (eds.): Neuorientierungen in den Beziehungen zwischen der Europäischen Gemeinschaft und den Entwicklungsländern, Berlin 1984, pp. 13-29.

<sup>2</sup> Commission of the European Communities: Memorandum on the Community's development policy, in: Bulletin of the European Communities, Supplement 5/82, Luxembourg 1982.

<sup>3</sup> D. Frisch, op. cit., p. 16.

industrialisation and even claims that to make industrialisation a priority was to "disregard history", since in the West agricultural development had been a prerequisite for industrial development.<sup>4</sup>

The co-ordination of development aid measures with activities of the recipient country and measures taken by other donors is certainly to be welcomed, insofar as it actually occurs. Policy dialogue as such is also to be viewed positively, although too much should not be expected of it, for if one or several donors adopt a cut and dried position in favour of promoting a particular sector a recipient that does not wish to risk a cut in aid has little option but to accept the priorities they propose (at least as far as the use of the resources in question is concerned). This is where the true problem lies.

Were one to ask whether giving priority *ex ante* to the promotion of rural development, agriculture or even specifically to achieving self-sufficiency in food production was advisable in principle, the answer would have to be negative.<sup>5</sup> Although it is conceivable that measures or investments geared towards these objectives will be highly efficient in socio-economic terms and have a strongly beneficial effect on development, this is by no means guaranteed. Even the laying down of the future structure of the economy after detailed analysis of the economy in question is rightly regarded as a dubious exercise in the case of the industrialised countries.<sup>6</sup> And yet industrialised countries, such as those belonging to the European Community, are now demanding not only that such structural control be accepted by developing countries but also that it be slanted *ex ante* generally towards rural development or even specifically towards food production. It can come as no surprise to discover that there is no sound justification for this. A shortfall in food production is hardly a valid indicator that promoting food production is likely to bring comparative advantages, let alone that it is consistent with the exploitation of those that already exist. If the promotion of food production does not accord with an economy's existing or attainable comparative advantages, it is likely to have a detrimental effect on national product and development

and may ultimately undermine the security of food supplies by reducing the country's ability to import.

Even less convincing is the fundamental scepticism about placing greater emphasis on industrialisation. Industrialisation has admittedly taken many wrong turnings in a large number of developing countries, but it would be a mistake to conclude that these countries – or indeed developing countries in general – are unsuited to rapid industrialisation. Most of the adverse experiences can be attributed to mistakes in industrialisation policy, such as practising an extreme form of protectionism that saps the vitality of development, promoting or protecting industries that can achieve no comparative advantages even in the long run, relying on public enterprises that operate inefficiently owing to a lack of management motivation and qualification, mismanagement and corruption, or finally constraining or misleading the development of private activities by imposing excessive state regulation while at the same time neglecting to ensure the elementary conditions for the satisfactory operation of markets, such as monetary stability and adequate continuity of economic policy.

### Prejudices against Industrialisation

It should not be forgotten, however, that a number of developing countries have already achieved such remarkable success with industrialisation that the EC believes it must protect itself against them. The relatively rapid industrialisation of many of these countries refutes the notion that Third World countries must go through the same stages of development as the industrialised countries and undergo a similarly long period of industrialisation if their industries are to be competitive in world markets. The fact that the situation of the developing countries of today is fundamentally different from that of the industrialised countries at or before the start of industrialisation also militates against this assumption. It should be remembered in particular that transfers of technology now enable the developing countries to manufacture goods in a wide variety of ways that were unavailable or unknown to the industrialised countries in earlier years.

These remarks should not be interpreted as advocacy for gearing development aid or development policy in general primarily towards industrialisation, but rather as a plea for a more open-minded attitude, for concentrating on efficiency and exploiting available development potential or attainable comparative advantages. Nor do they in any way conflict with the justified demands for a cessation of the discrimination many developing countries practise against agriculture,

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<sup>4</sup> Commission of the European Communities, *op. cit.*, p. 21.

<sup>5</sup> See E.-S. El-Shagi: *Vorrangige Ausrichtung auf die Förderung der Landwirtschaft und Ernährungsautonomie bei gleichzeitig restriktiver Handelspolitik: eine entwicklungsdienliche Politik?*, in: Gesellschaft für Umweltforschung und Entwicklungsplanung e. V. (ed.): *Entwicklungspolitik der Europäischen Gemeinschaft*, Saarbrücken and Fort Lauderdale 1984, pp. 40-60.

<sup>6</sup> See *inter alia* H. Besters (with the collaboration of V. Nienhaus): *Neue Wirtschaftspolitik durch Angebotslenkung – Offene Fragen überbetrieblicher Investitionsplanung und vorausschauender Strukturpolitik*, Monographien der List Gesellschaft e. V., new series, Vol. 3, Baden-Baden 1982, and the literature indicated therein.

which distorts resource allocation and impedes the development of the farming sector; these practices include setting low prices for farm produce, restricting agricultural exports or shifting the structure of prices to the detriment of agriculture as a result of the persistent and one-sided protection of industrial activities.

### **On the Stabilisation of Export Earnings**

The EC's policy on the stabilisation of export earnings also favours the bias towards agriculture and impairs the industrialisation of the countries concerned. The STABEX system helps preserve the agricultural orientation of their economies by providing only for the stabilisation of earnings from the export of agricultural raw materials and products at a low level of processing; this has the effect of reducing production risks and thus blunting the forces working for structural change. The SYSMIN system probably induces even greater inertia, since it provides for the use of compensation payments in the primary sector, that is to say mining.

Apart from tending to preserve the status quo, the EC's policy on the stabilisation of export earnings is problematic in various other respects; for example, basing compensation payments on lost earnings on exports of individual products, and even then only on exports to the EC rather than lost export earnings in general, means that substantial fluctuations in earnings may nevertheless occur, thus limiting the sought-after reduction in the financing risks attaching to development programmes. Moreover, it is obvious that the degree of stabilisation that can be achieved is further reduced by the level at which the trigger and dependency thresholds are set and by limitations on the funds available. Basically, it seems doubtful that compensation payments are a sensible means of stabilising export earnings over the longer term, since they do not treat the root cause of large fluctuations in export earnings, which in many cases are due mainly to insufficient diversification in the structure of production and of exports. In other words, compensation payments help preserve the causes of fluctuations because of their tendency to maintain the status quo. The fact that the STABEX system is confined to exports to the EC can also have an adverse effect in that it might impede a geographic diversification of exports.

The question also arises why transfer payments to developing countries, whether in the form of cheap loans or outright grants, should be tied strictly to losses of export earnings in any case. Such losses do not clearly indicate either neediness or the existence of conditions that promise a particularly efficient utilisation of the funds in question. A fall in export earnings may

even be due to a mistaken economic policy, such as an inflationary policy not accompanied by exchange rate adjustment. In such cases, compensation payments reward a failure of policy.

### **Trade Diversion due to Preferences**

Trade diversion effects harmful to Third World countries were already being generated by the marked differentiation in the "preferential treatment" accorded to the various developing countries; they have been accentuated by the southward enlargement of the EC. Another problem is that numerous and often increasingly stringent protectionist measures against imports from developing countries are still being imposed, despite the practice of preferential treatment.

Preferences can generate trade diversion effects in that countries not enjoying the preferences or which are granted a lower level of preferential treatment are at a competitive disadvantage against those that do receive them or are given more preferential treatment. Whether countries actually lose part or all of their market share depends largely on whether and to what extent the countries in question are in direct competition with one another in the markets concerned.

Take for example imports of industrial finished goods (excluding petroleum products) into the EC. The group of countries enjoying the greatest preferences, namely the ACP states, are hardly in a position to export such products today because of their technological backwardness. Accordingly, these items account for around 1 % of their total shipments to the EC.<sup>7</sup> This means that the more preferential treatment given to this group should have little discernible effect on exports of such products from other developing countries to the EC in the foreseeable future. The picture is very different as far as the Mediterranean countries are concerned. In 1980 the products in question made up 37 % of this group's total exports to the EC.<sup>8</sup> Bearing in mind the intensive industrialisation efforts in this region, the preferential treatment they enjoy is probably regarded as detrimental by other countries, particularly many NICs in Asia and Latin America. This in turn explains the hostile attitude of the Mediterranean countries towards extending preferences to the EC's industrial imports from Asia and Latin America under the Generalised System of Preferences.

As far as agricultural products are concerned, the more preferential treatment given to ACP states than

<sup>7</sup> See U. Möbius: Marköffnungstrategien: Globale und selektive Präferenzen sowie sonstige Formen der Handelsförderung, in: F. Franzmeyer, H.J. Petersen (eds.), op. cit., pp. 50-62.

<sup>8</sup> Ibid., p. 55.

Mediterranean countries is unlikely to cause trade diversion effects, since they export quite different products. Trade diversion at the expense of Asian and Latin American countries is more probable here.

### Effects of Southward Enlargement

The danger of additional trade diversion effects as a result of the southward enlargement of the EC – that is to say, the accession of Greece, Spain and Portugal – relates to both agricultural and industrial products and probably affects primarily the Mediterranean countries but also various states in Asia and Latin America. On the other hand, enlargement has probably caused no appreciable trade diversion effects for the ACP countries,<sup>9</sup> since their tropical products do not compete directly with products from the new member states and they do not in any case export a significant volume of industrial goods to the Community.

Adverse effects of southward enlargement on agricultural exports from the Mediterranean countries will probably stem mainly from the fact that many of the exports of these countries (except Jordan) are broadly similar to those of the new member states.<sup>10</sup> It should be noted in this connection that southward enlargement has enabled the Community to raise significantly its degree of self-sufficiency in a number of agricultural products that are traditional or important exports from the Mediterranean countries to the EC, such as citrus fruit, has caused market saturation in other products, such as vegetables of various kinds, and has even led to or exacerbated overproduction, as in olive oil and wine. The tendency to produce surpluses that crowd out the Mediterranean countries also in the markets of non-EC countries is likely to be reinforced when the Community's interventionist agricultural policy, with its guaranteed prices and other production incentives, is applied to the new member countries.<sup>11</sup>

As far as the effects on exports of industrial goods are concerned, a clear distinction should be made between

fields in which the EC pursues a liberal import policy and those to which restrictive practices apply. In the case of the former, the liberalisation of the new members' import policies as a result of harmonisation with that of the Community creates additional market openings for many industrial exports from the Mediterranean and other developing countries, not least on account of the relatively high price elasticity of demand in the new member countries.<sup>12</sup> Once competition increases, however, there is a danger that the acceding countries will be permitted to introduce protection, in accordance with the widespread practice of the EC.<sup>13</sup>

As regards those industrial goods for which the EC pursues a protectionist policy, southward enlargement and the associated reduction in barriers to imports from the new member states modifies the terms for competition or market access to the detriment of those Third World countries that export the same goods to the EC as the acceding countries or would be able to do so in future. Hence, southward enlargement will probably not only cause direct trade diversion effects at the expense of a number of countries but may also deter some of them from establishing or expanding the industries affected. The textile and clothing industry and steel are among the areas most at risk. Here again, it is

<sup>9</sup> See inter alia E. Guth, H.-O. Aeikens: Implications of the second enlargement for the Mediterranean and the ACP policies of the European Community, in: *Europe Information, Development*, published by the Commission of the European Communities, Directorate General for Information, X/235/80-EN, Brussels 1980.

<sup>10</sup> See J. B. Donges et al.: *The Second Enlargement of the European Community – Adjustment Requirements and Challenges for Policy Reform*, Tübingen 1982.

<sup>11</sup> See inter alia R. Taylor: Implications for the southern Mediterranean countries of the second enlargement of the European Community, in: *Europe Information, Development*, published by the Commission of the European Communities, Directorate General for Information, X/225/80-EN, Brussels 1980.

<sup>12</sup> See inter alia J. B. Donges, K. W. Schatz: Portugal and Spain entering the Common Market – Their Industrial Competitiveness Revisited, in: *Kiel Working Papers No. 233*, Kiel 1985, p. 22.

<sup>13</sup> See E. Guth, H.-O. Aeikens, op. cit., and J. B. Donges et al., op. cit., pp. 181 f.

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Mediterranean countries and newly industrialising countries in Asia and South America that must expect problems. The first southward enlargement had already brought tighter import restrictions on textiles and clothing for many of these countries, quite apart from possible trade diversion effects caused by the expansion of the common market.<sup>14</sup>

### EC Import Restrictions

In general, it can be seen that the protectionism operated by the EC towards Third World countries is a fundamental problem that casts "preferential treatment" in a different light or greatly reduces its importance, whether or not protectionism has become more damaging as a result of southward enlargement. The Community's policy of granting preferences to developing countries must not obscure the fact that many import restrictions are in force against these very countries, ranging from voluntary restraint agreements to quantitative ceilings to import bans.<sup>15</sup> What is particularly disturbing about these restrictions is that they relate chiefly to products that are important for many developing countries or in which they have or could soon have comparative advantages. Moreover, the restrictions are tending to increase and the markets in some products that have already been liberalised are being closed again to certain countries; textiles from Mediterranean countries are a case in point. Preferences are often granted only as long as the countries concerned do not have a significant supply capacity and cannot fully exploit the concession, whereas severe import restrictions are imposed mainly on countries that have built up a reasonably large production capacity and are dependent on exports.

It need not be emphasised that the export prospects of the developing countries are impaired not only by the EC's import restrictions but also by its interventions and export subsidies in the agricultural sector that stimulate overproduction. Whereas the Common Agricultural Policy conflicts to some extent with the aim of promoting agriculture in Third World countries, the erection of defences against industrial imports from developing countries and the consequent harm to their industrialisation plans is consistent with the Community's policy of channelling development aid primarily into the promotion of agriculture and impeding

the diversification of the manufacturing base by means of the policy on the stabilisation of export earnings.

The protectionism and interventionism of the EC and the consequences it has for the export sector of many developing countries must be considered particularly questionable today in the light of the massive indebtedness of a number of the countries concerned. The question arises how these countries can repay their debts if they are denied the possibility of achieving the necessary current account surpluses.

### The Food Aid Issue

One of the elements of Community aid to Third World countries that often draws sharp criticism is food aid. It is uncontroversial only to the extent that it is used for disaster relief.

Food aid is accused of:

- ☐ depressing farm prices in the recipient countries and thus harming agricultural production;
- ☐ easing the pressure on the governments concerned and thus leading to the postponement of necessary reforms or to the neglect of agriculture;
- ☐ failing to reach those in real need;
- ☐ consuming development aid resources that could be put to better use.

On closer examination, it will be found that the misgivings about food aid are far from convincing. Indeed, it transpires that food aid can be used in ways consistent with development – as well as in accordance with the declared intention of the EC – and that so far it has not been lacking a certain rationality.

With the free play of market forces, there cannot be serious doubt but that an expansion in the food supply as a result of food aid will depress the prices of the goods in question and hence cause production to be curbed.<sup>16</sup> However, this effect is diminished if food aid is distributed directly to those in need, whose purchasing power, and hence whose impact on demand, would otherwise have been negligible. It should also be borne in mind that farm prices, and especially food prices, are set at a low level in many developing countries irrespective of food aid, so that demand far exceeds supply. This means that even if food provided under such programmes is sold on the open market, as is the case with around two-thirds of EC food aid, it can have

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<sup>14</sup> See S. A. Musto: Die Süderweiterung der Europäischen Gemeinschaft, in: *Kyklos*, Vol. 34 (1981), pp. 242-273.

<sup>15</sup> See the detailed enumeration in H. Henselder-Barzel: Handelsrestringierende Praktiken der EG gegenüber Entwicklungsländern, in: F. Franzmeyer, H. J. Petersen (eds.), op. cit., pp. 63-73.

<sup>16</sup> See inter alia W. Lachmann: Möglichkeiten des Aufbaus einer eigenständigen Ernährungsbasis in den Ländern der Dritten Welt, in: Johannes Gutenberg-Universität Mainz (ed.): *Reihe Antrittsvorlesungen*, Vol. I, 1986, pp. 49-89.

only a limited impact on the prices obtained by domestic producers, as at least part of it will be absorbed by the excess demand. In such situations it is even conceivable that food aid will allow the price restraints on domestic producers to be eased somewhat; for example, Egypt is experimenting with a two-tier price structure, whereby food aid is used to supplement the supply of subsidised rations of basic foodstuffs to the mass of the population so that domestic producers can be allowed to charge higher prices without jeopardising people's minimum requirements.

Even where agricultural markets operate freely, the induced fall in food prices and its adverse impact on food production do not lead to a corresponding contraction in agricultural production overall, let alone a reduction in social welfare. As a rule, a fall in the prices of the foods concerned should cause production to be switched to increase the output of other goods. In other words, food aid may well cause a shift in the structure of prices and production, but it is unlikely to prejudice the utilisation of the available agricultural resources. It is obvious that food aid implies a welfare gain overall, for it constitutes an unrequited transfer of goods or income.

Viewed in dynamic terms, food aid can have substantial beneficial effects on development. It can help ease balance of payments constraints, for example. Nor should it be forgotten that it causes the cost of part of total consumption to be borne by other countries, thus increasing the propensity of the economy in question to save and invest. The aid can even be used directly for investment purposes, as the EC is at least attempting to do (e.g., food for work). It cannot be denied that this is not always possible and may be difficult to organise, but in principle there should be nothing to prevent the proceeds from the sale of food aid being used for broadly based investment purposes.

The complaints that aid often fails to reach those in need or that it can cause policymakers to neglect the agricultural sector are not without foundation, but they do not reveal any fundamental disadvantage of food aid, for they can be countered by trying to improve supervision and to make it conditional on increased efforts by the recipient country itself.

The argument that food aid diverts development aid resources from other more sensible uses ignores the fact that food aid on its present scale is the result of agricultural overproduction in the EC. In other words, as long as overproduction in the EC continues, a cessation

of food aid would not release resources that would then be available as development aid. In this sense, food aid should be regarded as a rational complement to the Community's agricultural policy, dubious though that be in itself.<sup>17</sup>

### Conclusions

The Community's development co-operation thus offers developing countries various advantages, but it is also problematic in several respects. Above all, the priority given to rural development and achieving self-sufficiency in food fails to convince, particularly since the Community's policy regarding the stabilisation of export earnings, the discrimination practised against more highly industrialised countries under the policy of preferences and the severe import restrictions on industrial exports from developing countries impede their industrial development. Another negative aspect is the fact that the development of agriculture is also hampered by the EC's protectionist and interventionist agricultural policy. Nevertheless, it cannot be denied that agriculture receives preferential treatment overall.

Policymakers in the EC are unable convincingly to justify the priority given to agriculture. One explanation may be that the industrialisation of Third World countries is regarded as detrimental to the industrialised countries, in this case the EC, and hence undesirable. It would be extremely regrettable, however, if that were really the view at responsible levels in the EC, for although greater industrialisation in Third World countries may cause some problems for the industrialised nations, such as an intensification of competition for natural resources or the loss of comparative advantages in certain fields of manufacturing, it would be questionable to conclude that the industrialised countries would reap more harm than benefits. Just the expected increase in the division of labour or the growth in trade should outweigh the negative effects, quite apart from the positive dynamic effects that would come from an increase in competition. Nor should it be forgotten that the instruments used in this connection, and especially import restrictions, are harmful to the industrialised countries themselves as well as the developing countries.<sup>18</sup>

The EC would undoubtedly do well to adopt a more liberal policy towards the Third World as a whole. This would entail not only liberalising trade policy but also desisting from practices that preserve economic structures and from setting *ex ante* sectoral priorities. At the same time, the developing countries should also review their own restrictive policies, not least in order to remove the alibi for restrictive measures from the other side.

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<sup>17</sup> Cf. E.-S. El-Shagi, *op. cit.*, p. 52.

<sup>18</sup> *Ibid.*