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Werner Glastetter*

The Integration of the Developing Countries into the World Economy

Despite decades of efforts, it has not yet been possible to integrate the developing countries satisfactorily into the world economy. Professor Glastetter examines the reasons for the failure of the integration strategies pursued hitherto and discusses the prospects of success with alternative approaches.

When the Western industrialised countries, led by the USA, set out their ideas for changing the world economy in the Atlantic Charter of 1941, their objective was both clear and plausible: to overcome the fragmentation that had found expression in trade restrictions and exchange controls already between the two world wars, increasingly hampering the international exchange of goods and factors of production and undermining factor productivities. The aim was therefore to stimulate a new process of worldwide economic integration in order to exploit the advantages of the international division of labour. With a view to the subject under discussion here, the results of their initiative were rather ambivalent, however.

In formal terms, the integration models were perfectly logical. The first aim was to develop a world trading system founded on the notion of free trade and laying down rules for opening up markets but providing for exemptions that allowed countries to adjust pragmatically to market liberalisation, in contrast to the unconditional most-favoured-nation principle of the classical free trade period. The second aim was to develop an international monetary system that would provide countries with international liquidity to finance the temporary balance of payments deficits that might occur with open markets, without immediately having to take "painful" domestic adjustment measures or reverse the opening of markets; this contrasted with the automatism of the gold standard during the classical period of free trade. Hence in principle it was a question

of reactivating the free trade idea, but translating it into reality in a pragmatic and financeable way. It was precisely this that was the message of the GATT and IMF Agreements that came into force in the mid-forties.

Viewed in concrete terms, the integration models were asymmetrical. They rested on the equal obligation on all member countries to open up their markets to foreign trade and to adjust their domestic economies. The principle of equal obligations presupposed however, that all participating countries had reached a comparable level of economic and social development. Only if that were the case could they be expected to meet the challenges of the world market and (supported by exemptions and liquidity assistance) to hold their own. Even among the industrialised countries this assumption was only partly satisfied; it was completely unrealistic as far as the developing countries were concerned, and it was here that the concrete asymmetry lay. A country that must face the challenges of the world market by opening up its economy will rapidly incur a current account deficit and liquidity problems if it is at a competitive disadvantage because of its level of development. As stated above, the opening-up of markets was flanked by the possibility of temporary finance in the form of the newly created international liquidity (drawing rights on the IMF). However, in accordance with the planned concept of the Fund, the supply of international liquidity was dictated not by countries' "needs" but by their previous "performance" in terms of GNP, foreign trade and official reserves, which formed the basis for calculating "quotas"; the quotas, in turn, determined not only voting rights but also countries' entitlement to international liquidity. The asymmetry therefore meant that the competitive

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(industrialised) countries had the opportunity to boost their growth and foreign trade by opening up their markets and thus to increase their claim to international liquidity, whereas the reverse was true of the competitively weak (developing) countries.

The model was tailored primarily to suit the aspirations and interests of the industrialised countries and was bound to hamper the integration of the developing countries into the world economy. The fact that most of the developing countries did not have political sovereignty at that time is no more than a superficial explanation for this lop-sidedness, for the special nature of the developing countries' needs as far as integration was concerned was already known in the forties. Not for nothing did the "Fourth Point" of President Truman's foreign policy emphasise the aim of achieving gradual economic and social structural change so that the developing countries could also participate in the process of economic development and integrate into the world economy. However, the notions inherent in this were reduced to the intention to allow the developing countries to share the industrialised countries' economic, scientific and technical knowledge and experience. Here the emphasis was therefore still placed clearly on technical assistance; direct capital aid was contemplated only if it was needed to implement the technical aid, in other words if it could be absorbed productively. Although there is no dispute as to the developmental importance of technical assistance – the transfer of know-how – this cannot conceal the fact that it is no more than a necessary condition for successful integration of the developing countries and not a sufficient condition in itself, as the scope for exploiting the know-how is directly limited by a lack of capital. This was the point over which polarisation soon set in.

Prerequisites Not Met

The industrialised countries were aware that the integration model was asymmetrical, but they were not prepared to make material alterations. The first revision of the GATT Agreement in 1955, not many years after it had come into force, did partially exempt the developing countries from the liberalisation code, and in 1965 the Agreement was extended by the addition of Part IV on trade and development, which emphasised the need for a rapid increase in the developing countries' export earnings, but the principle of free trade was preserved. At the world monetary level, additional credit facilities were created for the first time in 1963 to offset losses of export earnings and additional import costs (the oil facility), but this made no difference to the fund principle

of the IMF or to the quota principle. (At the end of the sixties, 25 years after the IMF Agreement had come into force, the industrialised countries held around 80 % of world monetary reserves; it is no coincidence that talk of reorganising the IMF and the debate about using the newly-created Special Drawing Rights for development purposes surfaced in the early seventies.) The revisions were therefore important steps, but they were not enough. They were inspired by the notion of indirectly "easing" the developing countries' integration into the world economy by making special provisions, but they did not imply the direct aid that would take account of these countries' special needs, in other words capital injections that would make such integration even possible.

The developing countries perceived the situation in precisely this way, setting out from the premise that if the prerequisites for integration are not met, a free trade concept will not lead to acceptable integration if it is merely sweetened by technical assistance and exemption from GATT and IMF rules. They saw that integration called for active help from the industrial countries. Conflict was therefore inevitable. In 1964 the United Nations Conference on Trade and Development (UNCTAD) was set up as a permanent institution of the UN General Assembly. From the outset its objective was indeed to promote international trade, but also to formulate terms for integration that took greater account of the interests of the developing countries than did the established institutions (GATT and the IMF). UNCTAD decisions have no legal force, but their clear objective is to influence the development policy of the United Nations.

This was evident in the strategy for the Second Development Decade (1970-1980), which was adopted by the General Assembly in October 1970. Its objectives were to achieve an annual average growth of 6 % in GNP (3.5 % on a per capita basis), an average annual growth of 7 % in exports, financial aid from industrialised countries equal to 1 % of their gross national product (of which 0.7 % was to be in the form of official aid) and a link between the creation of new Special Drawing Rights and development aid. These objectives were re-affirmed in principle in the strategy for the Third Development Decade (1980-1990), approved in December 1980.

The same line was also evident in the "Charter of Economic Rights and Duties of States" approved in December 1974 against opposition from the Western industrialised countries; it placed the protection of the interests of developing countries squarely in the forefront. In the spring of that year a Special Session of the UN General Assembly devoted to raw materials and

development had called for a "New International Economic Order", in which the market economy elements of GATT and the IMF were to be replaced by dirigistic intervention in the world economy, especially in the setting of world market prices, in order to take greater account of the interests of the developing countries.

Four decades of efforts to integrate the developing countries into the world economy have therefore produced no solution, only a hardening of attitudes. This justifies taking stock of the present situation.

The Current Situation

Although it must be conceded that data on the level of countries' development are imperfect and not fully comparable, two basic findings appear to be tenable:

- Although a comparison over time reveals partial improvements, a cross-section comparison between country groupings shows enormous disparities in per capita income and social indicators. Measured in terms of shares in world trade and rates of growth of foreign trade, the integration of the developing countries has been inadequate. There clearly remains an integration "need".
- Although partial shifts are evident in the comparison over time, a cross-section comparison shows significant differences in the structure of the work force, production and foreign trade. Apparently the greater the weight of the primary sector, the lower the level of development. The differences in the uses of national income are not quite so marked, but it can be seen that if the level of development is low the propensity to invest also tends to be low and that domestic absorption is over 100 %. Clearly, the integration "prerequisites" are still not being met.

These findings raise the question of the causes. Probably no-one would dispute that an explanation in

terms of a single cause is inadequate, but a decisive factor is undoubtedly the development of a specific form of the international division of labour, originally brought about by natural circumstances but deliberately fostered by many industrial countries during the colonial period. The developing countries were forced into the role of suppliers of agricultural products and raw materials, whereas the industrialised countries processed the raw materials, supplied themselves with consumer and capital goods and kept foreign trade in finished goods mainly among themselves. This form of the division of labour led to the recognisable difference in the value added pattern and the structure of foreign trade. In the case of the developing countries it accorded only in formal terms with the theory of comparative costs à la Ricardo, whereby free trade produces welfare gains for all the countries involved. This hypothesis assumes that all parties have equal market power, but in practice this prerequisite is not met, mainly owing to the specific relationship of supply and demand with regard to developing countries' exports:

- As far as supply is concerned, such a division of labour meant that the developing countries' exports continued to be limited mainly to primary products. Not only did this tie up resources which would otherwise not have been available for the industrial processing of the raw materials, but it also made for a low price elasticity of world market supply from the developing countries. In the event of a fall in world market prices, climatic and/or technical conditions make it impossible to restrict supply in order to prevent a further price fall. Instead, declining prices force supplier countries to raise output to compensate for the reduction in foreign exchange receipts.

- The industrial countries' demand for raw materials is also subject to restrictive conditions. The fact that both the price and income elasticities of demand for many

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ZWISCHEN SCHOCK UND KALKÜL

Die permanenten Verschuldungsprobleme der
Entwicklungsländer

BETWEEN SHOCK AND CALCULATION

The Permanent Debt Problems of the Developing Countries

VERLAG WELTARCHIV GMBH-HAMBURG

raw materials are well below unity means that developing countries must make substantial price concessions to stimulate any increase in demand, that they derive below-average benefits from world economic growth and finally that boosting supply tends to lead to a disproportionately large fall in price and a disproportionately small increase in the volume of exports. Since in addition the industrialised countries are trying to increase their self-sufficiency (agriculture), develop import substitutes (raw materials) and make savings (energy), demand tends to fall, or at least becomes even more inelastic.

Bleak Choice

This specific configuration of supply and demand was bound to call the Ricardo hypothesis into question, if not immediately then at least when the supply of or demand for the industrial countries' products showed high price and income elasticities, for market conditions then imply no equality between industrial and developing countries. The developing countries have high requirements of products from industrial countries and must accept the prices asked, but they are faced with inelastic demand from industrial countries and must make price concessions. The obvious consequence is a deterioration in their terms of trade. Despite sharp fluctuations, calculations show that in the mid-eighties "real" raw material prices (deflated using the prices of industrial countries' exports) were some 30% lower than at the beginning of the fifties. This means that the developing countries' exports now cover only around 70% of the volume of imports they once covered, or put another way that their exports would have to increase by around 30% for them to be able to finance the same volume of imports.

It is obvious that this particular division of labour impeded industrialisation directly, since resources had to be invested in the primary sector, and jeopardised it indirectly, since imports of goods essential for industrialisation remained limited. This inevitably gave them a bleak choice: either curb import demand or finance it by means of credit. The seeds of Third World debt, which has come dramatically to a head in the eighties, were sown by this configuration. The shortage of foreign exchange caused by falling export prices and rising import prices has been exacerbated by rising debt servicing obligations. This inevitably further restricts the scope for imports. There is also a danger that additional loans must be used to service past debts.

Ultimately, the developing countries require "capital" to create the production structure that is a prerequisite for integration into the world economy, and hence for

coping with world market competition. If in the light of the situation outlined above – namely the deterioration in the developing countries' terms of trade and the debt servicing burden – we assume that simply opening up markets will not produce an adequate inflow of capital, even with exemptions from GATT and IMF rules, the developing countries will need active assistance from the industrialised countries if they are to integrate. Two forms are conceivable: "direct" capital assistance (financial transfers) and "indirect" capital assistance that gives developing countries the opportunity to earn the necessary capital themselves by exporting (real transfers). "Aid" and "trade" are not alternative strategies in this context, but must be combined, for aid without trade would degenerate into charity and trade without aid would be virtually functionless.

We may assume that "direct" capital aid is conceptually uncontentious and at worst poses problems of practical implementation, but we cannot make the same assumption with regard to "indirect" capital aid, for here the question arises whether and how the developing countries should integrate into the world economy. Three alternative integration models have been developed in response to that question.

Import Substitution

The import substitution concept is based on minimising the developing countries' integration into the world economy. The objective of industrialisation behind tariff walls should be to cater for the home market and to replace imports as far as possible in order to save foreign exchange. The investment multiplier unmistakably plays a leading role in this concept. Seen in terms of the domestic economy, the concept would have the advantage of being highly appropriate in terms of needs (catering for domestic demand), income distribution (abstention from low-wage dumping) and employment (use of labour-intensive technology regardless of international productivity disparities and consequent competitive disadvantages). From the external point of view, the concept would take account of the fact that the country's competitiveness in terms of the level of technology and the qualification of the labour force is low by comparison with industrialised countries. It would not by any means provide complete insulation from the world economy, since some foreign exchange would be required to purchase capital goods and technical know-how, so that complete import substitution would not be possible. Nevertheless, the central aim is to minimise import demand, build up a protected, domestically orientated production structure, limit exports of industrial goods and finance essential

foreign exchange requirements by exporting primary products.

However plausible the model, the weaknesses that ultimately led to its downfall are unmistakable. First, it presupposes that the country's foreign exchange needs can be met by exporting primary products. The deterioration in the terms of trade has dashed that expectation and forced the developing countries to use their resources to increase the supply of primary products instead of investing them in industrialisation aimed at meeting domestic demand. Secondly, it assumes that the domestic market can be developed quickly. This expectation has also proved deceptive, for the starting base of poverty and mass unemployment has worked against the development of the domestic market. The intended process of industrialisation – and hence the hoped-for investment multiplier – were therefore under the double burden of excessive resource absorption and an inadequate propensity to invest, which made the concept seem increasingly questionable.

Export Substitution

The conclusion often drawn from the failure of the import substitution strategy was that instead of trying to insulate themselves the developing countries should strive for a form of international division of labour based on the notion of direct competition with the industrial countries for at least part of the markets in their fastest growing exports. In theory, this model assumes that the substitutive exchange of goods offers the greatest opportunities for growth to all the parties involved, the developing countries included. This notion is based on two considerations; first, if it is correct that the products offered by industrial countries occupy a comparatively favourable position in the world market on account of their technical standard and demand elasticities, it follows that the developing countries must also supply these goods in the world market, and secondly, if the domestic market cannot be developed quickly and sufficiently and thus fails to trigger the investment multiplier, the latter must be replaced by an export multiplier triggered by foreign trade. On the basis of these considerations it has generally been concluded that the developing countries must first build up a competitive, export-oriented industry, aided by direct investment from industrialised countries, which would also supply the necessary know-how. The income generated could then contribute directly to the development of the domestic market and the foreign exchange earnings would provide further indirect support by enabling the purchase of imports required for

domestically orientated industrialisation. Hence in this model it is not the investment multiplier but the export multiplier that plays the leading role.

However plausible this model may be, it too has shortcomings that have ultimately caused it to fail. It postulates a development of production requiring a high capital input and a certain minimum level of infrastructure, above all a core of skilled workers. Even if the industrial countries contribute technology and capital, the conditions needed to trigger the export multiplier are not fulfilled. First, the industries in question are very capital-intensive, so that from the very outset there is no real basis to the expectation that wage incomes will enable the domestic market to develop. Secondly, the less it can be assumed that the demand for capital or capital goods will be met by once-and-for-all transfers from industrialised countries, the more it must be taken for granted that high amounts of foreign exchange will continue to be required to purchase such goods. This means that foreign exchange earnings cannot be spent on imports that promote domestically orientated industrialisation. Competitive export industries have indeed been developed in certain branches in some countries, but they have remained enclaves in the economy since the effects of the export multiplier have not spilled over into the domestic sector.

“Division of Labour” Concept

The division of labour concept is based only indirectly on Ricardo's classical theory of comparative cost advantage, taking its lead instead from the refinement of this in the factor proportions endowment theorem by Heckscher and Ohlin. Its central tenet is that an exchange of goods on the basis of specialised industrialisation has beneficial income and productivity effects. Accordingly, a country should not seek to produce substitutes for its own imports or for other countries' exports that have growth potential but should concentrate on the production and export of those goods in which it has a comparative advantage, especially an abundant supply of the necessary factors of production. To varying degrees, developing countries are well endowed with agricultural and industrial raw materials and have a large but rather poorly qualified work force; what they lack is physical and human capital. This gives them locational advantages in two fields: in processing industries with a high raw material input (such as food, drink and tobacco, leather production and processing, and the processing of wood, cork and non-ferrous metals) and in labour-intensive and wage-intensive activities, especially finished near-consumer goods industries (such as textiles, clothing,

shoes, furniture, glass, ceramics, toys and sports goods, electrical appliances and cars). Most of these are goods that were originally developed in industrial countries at high R & D cost, have completed a product cycle and have now reached a stage of standardisation at which they can be copied fairly easily.

It is obvious that the concept of the division of labour on the basis of complementarity and comparative advantage is a more viable trade option than the two substitution concepts. The chances of achieving substantial foreign exchange earnings should be greater than with either import substitution or export substitution, in the first case because the concept does not depend solely on exports of primary products that are vulnerable to a fall in price, and in the second because it can bank on higher competitiveness. Furthermore, there should be a greater chance that this concept will stimulate the development of the domestic market, since the latter does not have to rely on the investment multiplier, as it does with import substitution, and the export multiplier is more likely to materialise than with the export substitution concept. Of the three models, the concept of labour-intensive and/or raw-material-intensive industrial processing would be the most likely to generate the conditions required for specialising in particular areas of foreign trade that provided adequate development stimulus.

General Limitations

In putting "theoretical solutions" into practice it must be noted that there are general limitations on the extent to which developing countries can be placed in a position to integrate into the world economy. This is true even of "direct" capital aid, the need for which is not in dispute:

□ Difficulties arise *ex post* with regard to the treatment of existing debt. It is true that the international financial system has shown sufficient flexibility to avoid a great crash, but solutions are needed nonetheless. Irrespective of the technical financial details, there is dispute above all as to whether global or individual solutions are appropriate and whether rescheduling agreements or a general moratorium are needed.

□ Difficulties also arise *ex ante* if it is a question of aiding developing countries by means of future capital transfers. It is not in dispute that private direct investment is immensely important, particularly as it is combined with the transfer of technical know-how. However, the developing countries have reservations in this regard as well (yield aspects, transfer of profits, stabilisation of the structure of society). To that extent

one can therefore sympathise with their demand to deprivatise or nationalise "direct" capital aid, but here too there are problems, such as the question of "across-the-board" financing versus project funding, the problem of tied aid and that of official promises being broken. From this perspective it can be seen that even direct capital transfers are subject to limitations that make it appear all the more imperative to supplement them with "indirect" capital transfers via the developing countries' own export earnings. However, since the substitution concepts are only partially effective for development and integration purposes, it follows that the ultimate objective should be to work towards a "division of labour concept" that allows the developing countries to exploit their comparative advantage.

This conclusion is not itself controversial, and yet it is surrounded by a field of tension the significance of which increases in proportion to the severity of the restrictions imposed on direct capital aid:

□ On the one hand, the developing countries will succeed in building up an industrial sector in line with the concept of the international division of labour only if the industrial countries cease to protect those of their industries in which they have a comparative disadvantage. The industrial countries are therefore obliged to open up their markets and to allow those industries in which they are at a disadvantage to be transferred to the developing countries.

□ If the industrial countries are not prepared to do this, the developing countries must fall back on their traditional products (food and raw materials) to provide the foreign exchange they need. However, the greater the danger that, for objective market reasons (low supply and demand elasticities, conservation and substitution processes), their foreign exchange earnings will be too low to finance the import requirement, the more inclined they will be to alter the relevance of market conditions for price determination, and in certain circumstances to reject the GATT free trade concept altogether.

This reciprocal relationship shows that the obligation on the industrial countries to open their markets does not derive solely from a ("moral") demand to make self-help possible; it springs from this concrete choice, which sets the tone of the debate and also hardens attitudes. For a successful comparative division of labour presupposes that the developing countries manage to diversify their exports. The centre piece would have to be a manufacturing industry supplied by the country's own raw materials. The export range could then perfectly well include finished industrial goods. A further

advantage would be that with a product structure of this kind the need for imported capital goods would be at least partly reduced, provided the emphasis lay on labour-intensive technologies that at the same time helped solve the existing employment problem.

There are countries that have followed this path and become newly industrialising countries. Many have convincingly diversified their range of export goods. The cliché that textiles are the only product in which developing countries can make a showing in world markets no longer has any basis in fact; in many cases half of their range of exports consists of electronic and engineering goods. Nevertheless, such success is confined to a small number of countries (Taiwan, South Korea, Hong Kong, Singapore, Israel and South Africa) or those that have accumulated particularly heavy debts (Brazil, India, Mexico and Argentina).

Concrete Restrictions

The limited success developing countries have had integrating on the basis of the division of labour concept points to the existence of concrete restrictions. They are to be found on two levels:

□ **Micro-economic obstacles:** From the point of view of developing countries it must be borne in mind that the creation of a raw-material-intensive and/or labour-intensive production structure initially necessitates imports and hence foreign exchange earnings. If the manufacturing industry is established and financed mainly through private direct investment by enterprises from industrial countries, the project will have a positive effect on domestic development but there is a possibility that it will generate no net export earnings for the developing country. Private-sector investment is based on considerations of profit, and maximising export earnings for the developing country does not enter into the equation. Other motives are likely to be uppermost, such as opening up new markets or exploiting wage and other cost advantages, tax concessions or domestic political aspects, such as the weakness of trade unions. Studies have shown that multinational companies in particular attach very restrictive conditions to their direct investment, such as allowing the products to be sold only in the domestic market of the developing country, thus preventing export expansion a priori. Alternatively, export expansion may be possible, but the corporation attempts to transfer the foreign exchange earnings back to its home country in the form of returns on capital. In both cases, private-sector direct investment can have an important and noteworthy impact on domestic growth and employment, but one way or another the

equally important foreign exchange earnings needed to finance imports do not materialise.

□ **Macro-economic obstacles:** A comparative division of labour concept, though adequate in development terms, would present the industrial countries with a tremendous challenge, for the division of labour would change its nature. If the foreign trade concept only entailed export substitution, the effects would be confined mainly within individual industries; competition would operate between individual firms within the same branch of activity, with companies breaking into foreign markets or being squeezed out of their domestic markets. Structural change would occur with little or no friction, and often unnoticed. However, if the foreign trade concept involved complementary-comparative division of labour, entire industries would increasingly find themselves competing against one another. If particular industries have appreciable competitive advantages in developing countries on account of their high raw material and/or labour intensity, entire industries in industrial countries would become uncompetitive in a situation of free market access. For that reason an inter-industry division of labour would be more beneficial for developing countries but problematic for industrial countries except in a situation where the latter registered high growth rates and overemployment. In the seventies and early eighties however real growth in the industrial countries has slowed down considerably and at the same time unemployment rates have risen dramatically. A reversal of this trend is not in prospect. This turn of events has itself led to a fall in imports from developing countries, but in addition the industrial countries have clearly felt no longer able to face the challenge of structural change outlined above. They are protecting themselves with an ever increasing armoury of protectionist measures against imports of industrial goods from developing countries. In order to jump these hurdles the developing countries must continually improve their competitive advantage, for which they promptly earn accusations of price and wage dumping, an accusation that has undoubtedly never been entirely unjustified, but which is now certain to provoke calls for yet more protection; in essence, a new vicious circle is being created. The last round of GATT negotiations in Tokyo was therefore unable to prevent the comparative division of labour concept from being stalled (in partial contravention of GATT rules) for macro-economic reasons, too.

It becomes clear that as far as the choice between progress towards the division of labour concept or reversion to the raw material concept is concerned, at present it is still the latter that prevails. It can therefore

come as no surprise that the developing countries increasingly refuse to continue to submit their exports of raw materials to the terms dictated by the free world market.

Stabilisation of Export Earnings

In principle, two alternative concepts are then open to developing countries:

1. The *stabilisation of earnings from primary products* aims to stabilise the developing countries' foreign exchange receipts directly via credit facilities. A credit facility of this kind was created at an early stage by the IMF, but the concept achieved greater prominence in the Stabex model of the Lomé Conventions between the EC and the countries of the African, Caribbean and Pacific regions (the ACP states). The Conventions attempted to establish a global scheme concentrating on two main points:

□ At the commodity level a system was developed with a view to stabilising export earnings, the so-called Stabex system. If the proceeds from EC imports of a product accounting for more than 7.5% of an ACP country's exports (the dependency threshold) decline by more than 7.5% (the trigger threshold) the country can apply to the EC Commission for a financial transfer; transfers are interest-free, but repayable. For the poorer ACP countries the dependency and trigger thresholds have been reduced to 2.5% and the repayment requirement has been partially waived. The volume of finance available has risen from ECU 3 billion under Lomé I (in force until 1980) to ECU 5.5 billion under Lomé II (in force until 1985) and finally ECU 8 billion under Lomé III, which is valid until 1990; the three Conventions provided sums of ECU 375, 557 and 925 million respectively for earnings stabilisation. The objective is clear – not to interfere in the determination of commodity prices (by means of price stabilisation or indexation, for example) but to stabilise earnings by granting credit. This arrangement is undoubtedly preferable to the IMF's compensatory financing, which is limited by quotas and bears interest, but a number of problems remain unresolved. Apart from the need for sufficiently accurate statistics, the scheme does not apply to important products that are classified as "sensitive" in the EC but are significant to the ACP countries. In addition, it necessarily leads to bi-polar trade flows, since exports to non-EC countries are not eligible for assistance; this causes regional differentiation and discrimination against non-ACP countries (in contravention of GATT rules). Above all, however, it implies only earnings "stabilisation", and not earnings "enhancement", and – although there are

exceptions – fluctuations in earnings are only smoothed out by means of credit; in other words, the earnings problem is replaced by a debt problem, which seems a highly questionable solution in view of the developing countries' need for foreign exchange and the volume of debt they have already accumulated.

□ At the trade level the Conventions adhere to the principle of non-reciprocity. Exports from ACP countries are not subject to customs duties, quotas or comparable restrictions; in return the ACP countries do not grant EC exports equivalent preferential terms but only most-favoured-nation treatment. This arrangement accords with Part IV of the GATT, which was adopted in 1965, and is also designed to avoid deliberate discrimination against third countries. Here too a number of problems have remained unresolved, however. For example, products that are important to the ACP countries but whose unrestricted importation could upset the EC agricultural market regime are also excluded from the trade provisions, and quotas and special arrangements have been agreed for a number of other products. Hence the ACP countries do enjoy preferential treatment, albeit with certain "painful" exclusions.

In short, the Lomé Convention has made important progress in respect of earnings stabilisation – with built-in mechanisms for EC payments – and preferential treatment for the poorest countries, but it still does not seem to have gone far enough, as has become clear in the negotiations at each renewal of the Convention between the EC and the 56 ACP countries that are now signatories.

Stabilisation of Commodity Prices

2. The concept of *commodity price stabilisation* aims to increase or stabilise export earnings not by providing temporary finance but by means of selective price intervention. At UNCTAD IV in Nairobi in 1976 the demand for action of this kind found a response in the "Integrated Commodities Programme". The proposal was fiercely contested from the outset. When it was nevertheless finally adopted, with some industrial countries expressing reservations, it laid down no concrete commitments, only "timetables". The Programme was discussed again at subsequent UNCTAD conferences, although without significant progress being made, and this despite the fact that its scope was narrowed from 18 to 10 "core" commodities and the finance reduced from a range of between \$ 10 and 13 billion to one of between \$ 3 and 6 billion. At the end of the seventies it was decided to set up a "Common Fund" with finance of \$ 750 million (\$ 400 million for buffer stocks and \$ 350 million for marketing). Both the

number of commodities covered and the volume of finance are now lower than with Lomé III. In addition, important demands for supply and purchasing commitments have been rejected. Nevertheless, it was not before mid-1988 that the Programme was ratified by the requisite number of countries, although the final level of Fund resources has still to be determined.

The main aim of the Programme, apart from giving developing countries greater support with regard to processing their raw materials and diversifying their exports, is to prevent sharp fluctuations in prices and earnings while at the same time improving the developing countries' terms of trade. These objectives are to be achieved by removing important raw materials from the free world market. First, commodity agreements would be concluded to stabilise prices or index them to the world inflation rate. Secondly, to prevent possible falls in demand at these prices, long-term supply commitments on the part of developing countries and purchasing obligations on the part of the industrial countries would be laid down and safeguarded by production and export quotas. Finally, a Common Fund would be set up, which would not only finance buffer stocks but would also be empowered to make intervention sales or purchases in the commodity markets in "critical situations" in order to counteract fluctuations in prices and hence in earnings. This programme would combine long-term price and sales guarantees with short-term interventions. It has triggered fierce controversy, mainly on two levels.

□ First, on the fundamental level of the basic principle underlying the world economic order, in which there is a complete contrast between the GATT and UNCTAD concepts. On the one hand there is the GATT concept, based on the principle of free trade, which it wants to apply also to trade with developing countries, albeit in modified form. On the other there is the UNCTAD concept, which quite clearly wants to abandon the free trade principle and replace it by commodity agreements and systems of preferences. That this conflict could arise at all can be attributed in no small measure to the fact that for two decades after the end of the second world war the industrial countries did not recognise that the integration of the developing countries raised special conceptual problems that made an absolute free trade concept questionable, given the supply and demand conditions that existed. In the light of the activities of UNCTAD, they hastened to take account of the developing countries' interests by adding Part IV to the GATT, but without altering the substance of the Agreement itself. The incorporation of Part IV was therefore not a step forward conceptually; that would

necessarily involve choosing between a "free" world economic order and a "planned" one, a choice that would lead to ideological conflict if a "free" economic order failed to provide development gains owing to abuse of the economic freedom it permitted.

□ The practical objections to the programme probably carry greater weight. This concept could bring about a real transfer of resources only if commodity prices could be kept above a market equilibrium level, however that may be defined; otherwise, price determination might as well be left to the market. This inevitably raises a host of problems, however: the problem of outsiders and the question of possible sanctions, induced overproduction accompanied by expensive buffer stocks and/or dirigistic production quotas, a weakening of the incentives to diversify, disadvantages for those developing countries that have few raw materials and benefits for industrial countries that are well endowed, loss of earnings due to substitution of commodities and/or curtailment of raw material consumption, and an acceleration in inflation as a result of indexing commodity prices. No-one would deny the existence of these problems. However, switching from price stabilisation to earnings stabilisation (whether along the lines of the Compensatory Financing Facility of the IMF or the Stabex model used by the European Community, both of which are preferred by the opponents of commodity agreements) does not solve the problems either, since fluctuations in earnings are only offset temporarily by credit, with foreseeable consequences if a shortfall of foreign exchange earnings persists. Ultimately, this would lead to a situation in which a transfer of resources either did not take place at all or was achieved only at the cost of increasing indebtedness on the part of the primary-producing countries. This would obviously do nothing to solve the outstanding problems.

Dilemma of Integration

The practice of integration policy is still a long way from achieving a comprehensive and convincing solution of the problem. This much is clear: if the industrial countries persistently attempt to block the complementary integration of the developing countries into the world economy, the need for capital aid will become all the more urgent. However, even if the promised aid were granted, it would in itself solve nothing if all it did was to create a vicious circle between the granting of aid and the denial of export diversification, for then the developing countries would be virtually forced to adopt an export strategy that would lead to an equally questionable attempt to manipulate the prices of their existing range of exports.