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Center Discussion Paper No. 200

NORTH-SOUTH RELATIONS: THE ECONOMIC COMPONENT

Carlos F. Díaz-Alejandro

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## North-South Relations: The Economic Component

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### I. Introduction

This paper will present a framework for viewing North-South economic relations which, it is hoped, will facilitate positive analysis, and contribute toward normative prescriptions regarding the desirable trend of North-South economic relations in the future.

Possible social and economic typologies of "Southern", or less developed countries (LDCs), will first be explored, as international economic links differ in importance among groups of states. Key features of the political economy of the "Northern countries" (DCs) will also be examined. The arena of interaction between North and South will then be discussed, focusing on fundamental asymmetries in the working of the international economic system. This will be followed by more detailed analysis of international commodity and factor markets. The implications of such analysis for international aid and economic monetary reform will be discussed toward the end of the paper.

The economist will quickly recognize the basic theme of this essay: the analysis of different types of international markets, viewed as more or less desirable mechanisms for handling economic interdependence among nations. The desirability of such mechanisms will be judged not only on the basis of their purely economic efficiency, but also on whether they help or hinder the achievement of other national goals. The point is to

search for mechanisms to handle international interdependence which are compatible with the pursuit of a variety of purely national goals. The search is motivated by the assumption that two apparently contradictory forces will continue to dominate this century: a technology which makes the international division of labor economically attractive, and a desire for political and cultural self-determination of states and/or ethnic groups.

The paper will view markets as creatures of social and political systems, not as mechanisms arising spontaneously and inevitably out of economic necessity. Which markets are allowed to operate and how, which are encouraged and which are repressed are political decisions, both nationally and internationally. On the other hand, there are in some cases technical difficulties which even a firm political will to create an international market may be unable to overcome at reasonable social costs. Other mechanisms may then be called upon to handle international interdependence.

## II. The South: Types and Strategies

LDC economic and political heterogeneity, more so than that of DCs, presents a difficult barrier to generalizations about North-South relations. But postwar research on LDCs has yielded some "laws of development," which can be helpful in sorting out a manageable number of LDC types, at least in the economic sphere.

The work of Kuznets and Chenery, in particular, has isolated certain impressive regularities in the path toward higher per capita income.<sup>1</sup>

Much of the observed variation in the productive structure and export pattern of LDCs can be econometrically explained by per capita income and by population. A third important variable is the endowment of natural resources of a given country. In other words, if one knows, for a given LDC, per capita income, population and resource endowment (somehow quantified), one can make a very good guess about the structure of production and foreign trade in that country.

One can thus differentiate between large and small LDCs, and between those relatively rich in natural resources and those which are not. As each type of country moves up the per capita income ladder, its productive and international trade structures will change in a fairly predictable way, given contemporary technology. A large, resource-poor country with a low per capita income, such as India, will have different priorities for its economic interactions with DCs, than a smaller, relatively resource-rich LDC, already well along the per capita income ladder, such as Chile. The Kuznets-Chenery empirical patterns of growth also suggest that once the three major objective facts listed in the previous paragraph are taken into account, the key variable influencing changes in productive and trade structure is the growth rate of per capita income. Domestic policies, this line of thought would argue, will affect those structures mainly via their impact on per capita income growth. Indeed, domestic policies trying to change those structures directly, in contradiction with the three objective facts, will simply decrease the growth rate, without much changing the productive and trade structures of the country (e.g., the case of Uruguay,

which defied its "fate" or pattern as a small, resource-rich country).

The above has a deterministic flavor leaving little room, apparently, for policy innovation, except insofar as it can accelerate growth. It could be countered, inter alia, that such generalizations are based on observations of more or less market-oriented LDCs, leaving aside the experience of socialist countries. Yet, there is some evidence suggesting that the invariance of productive structures except to the three objective variables also extends to socialist countries. It could be that the major difference between a socialist and a capitalist LDC of the same per capita income, population and natural resource endowment will be not in productive and foreign trade structure, but on the structure and distribution of public and private consumption and investment. The striking originality most observers find in the Cuban economy, for example, does not certainly lie in its production and trade structure, which probably fits well in the Kuznets-Chenery patterns. But more evidence is certainly needed in the comparison of socialist and non-socialist trade, production and expenditure structures. The experiences of the Peoples' Republic of China, in particular, are only beginning to be incorporated systematically into development studies. It remains to be seen whether and when such incorporation will yield another Indian-type observation, or something qualitatively different.

So some of the deterministic flavor arising from the descriptive "laws of development" disappears when one considers the political and economic possibility that a given pattern of production and trade, broadly defined,

will be compatible with more than one pattern of expenditures and income distribution. The latter patterns may differ in the balance of consumption of private and public goods, in the level of other social services, in the equity of income distribution, etc. A priori, one could argue that such differences will be reflected in the pattern of production and trade. The hypothesis is that the link is weak, and overshadowed by the three variables discussed earlier.

This hypothesis receives some support from recent simulation exercises showing that even radical redistribution experiments affect the sectorial composition of gross output only modestly, and that resulting indirect effects on importation, and on capital and labor use are correspondingly modest. Moreover, even or more concentrated income distributions seem feasible under a variety of basic development strategies.<sup>2</sup>

From the above it follows that in today's world the manner in which the international economic links of a given LDC will influence its domestic economy, its expenditure structure and its internal political balance cannot be assumed mechanically from a knowledge of its trade pattern. Exports of sugar may strengthen the oligarchical power of landlords and finance luxury consumption, or sustain the building of socialism.

Regardless of which groups are leading and controlling the process of capital accumulation, determining the distribution of its fruits, and the burdens of adjusting to change, a given LDC will have an interest in international economic relations which will vary depending on its income, population and natural resources, but which in almost all cases is likely

to be strong and viewed as a potential source of economic gains. The gains will be mainly those usually associated with the division of labor, whether in commodities or technology. During transitional or revolutionary periods, rejections of the international link may occur, but such withdrawal will typically end with the establishment of a new political order.

The international link, of course, can be manipulated by the ruling groups or classes not only to achieve broad socioeconomic goals, but also to strengthen their own narrow economic or political interests. Ruling LDC groups, for example, may be eager to welcome direct foreign investment from a hegemonic country not for the sake of obtaining capital or technology, but with the expectation that by thus tying the fortunes of those investors to the political survival of the allied LDC groups, their power will be strengthened by the acquisition of lobbyists within the councils of the rich and powerful.

To avoid misunderstanding it should be stressed that the "laws of development" obtained using data generated by postwar history and technology will not necessarily apply to 19th or 21st Century circumstances. But at the very least they offer a compact and manageable summary of the heterogeneity of the LDCs.

### III. The North: What Matters Most for the South

From the viewpoint of the South, the following interrelated questions are the most crucial regarding Northern economic characteristics. Is the Northern demand for Southern goods and services expanding fast? Are the Northern countries competitors vis-a-vis the South, or do they tend to



present a common, cartelized front in most economic transactions? Are there groups within the DCs which have specific and quantitatively strong economic interests in LDCs, and are there many or few? If there are such groups, are they politically powerful within the DCs, so that they exert an important influence on DC public policy toward LDCs?

Historically, for a given LDC the typical answers to these questions were not encouraging: LDCs dealt with DC economic groups which were few and concentrated, which had the ear of their respective governments and whose well-being were perceived to depend heavily on profits from LDC operations. Rivalries between DC economic interests were kept down by formal or informal divisions of the third world, assuring each hegemonic power of its own preserve. DC demand for LDC products, quite dynamic before the First World War, turned sluggish between then and the 1950s, except for petroleum.

The picture for the 1960s reveals some improvement for the LDCs, reflecting slow-working historical forces. The full presence of the USSR in the world scene has introduced not only just one new major competitor among the great industrialized powers, but also one with an ideology making it less likely to play by the old rules of the capitalistic game. Furthermore, with the passing of cold war confrontation, the presence of the USSR need not reduce competition within the capitalist camp, opening up a potentially more fluid world scene for at least some LDCs.

While the presence of the USSR has essentially provided a security umbrella for some LDCs, under which economic and political decisions have been taken which in the old days would have led to overt or covert military

intervention by capitalistic LDCs, the postwar economic expansion of Japan has brought back into the world stage an actor missing since around the First World War: a rapidly growing, resource-poor, industrial archipelago with a high propensity to import primary products.

The improved and still expanding economic and political expertise of LDC policy makers has allowed many of these countries to take advantage of the more favorable world circumstances, to achieve not only economic goals but also a more effective degree of national autonomy. Yet, the interplay between forces toward cartelization and those for rivalry and competition is far from settled in the North. Evidence could be produced for the argument that either one or the other is likely to prevail, say, during the next ten years. On the cartelization side consider, for example, trends toward Western European unity, US-USSR cooperation, concentration of capitalistic trade and production in multinational corporations, and increasing cross investments in the securities markets. But my own guess is that the presence of a socialist camp which does not threaten militarily Western Europe and Japan tips the scale in favor of a scenario of at least oligopolistic rivalry among DC economic interests, permanently at the verge of warfare.<sup>3</sup>

Such warfare, even assuming it remains purely economic, is not without some dangers for LDCs. It could lead to a breakdown of prosperous, multilateral world trade, reducing world demand for LDC products and rekindling pressures for reviving neo-colonial "special relationships" between subsets of DCs and LDCs. Under those circumstances, LDCs could suffer not only from concentrated DC economic groups using their political

power, but also from an increase in populist DC pressures, such as those arising from beet farmers and textile producers in those countries.

#### IV. The Choice of Arenas of North-South Economic Interaction

It is tempting to separate North-South interactions into political and economic spheres, the former being direct and the latter indirect, operating via different markets. The distinction, of course, cannot be that clear cut. In particular, market rules of the game, and the determination of which markets are allowed to operate, are essentially political decisions. Power, whether military or corporate, abhors an uncontrolled and truly competitive market. It would be an extraordinary world in which asymmetries in military and political power were not reflected in asymmetries in economic relations.

This seems quite straightforward, and has been at the root of "center-periphery" or dependencia schemes for a long time. Yet, by a curious psychological mechanism, similar to that which leads some to blame the victim for a crime, even informed liberal opinion in DCs often views LDCs emphasis on such asymmetry with ill-disguised impatience, or with a curious eagerness to show up minor inconsistencies in LDC arguments.

Take, as an illustration, the goal of world economic efficiency. A pure technocrat would know that there are several possible ways of approaching that target: freer trade in commodities, freer international capital movements, or freer labor migration. It may not be necessary, in fact, to follow all of those policies, as trade and factor movements are all substitutes for each other, at least in the type of models on which efficiency policy

advice is often based.<sup>4</sup> The obvious question is: why not seek world efficiency via labor movements instead of capital movements? Or why via some type of capital movements (direct foreign investment) rather than others (portfolio investment)? Why world efficiency is sought via one combination of policies (capital having the option of going to immobile labor), rather than with other possible packages is explained less by references to Malthusian specters than by looking at who makes the rules regarding which markets are to operate, and how.

It is instructive to compare actual Western European treatment of immigrant labor with the treatment some LDCs have tried to impose on immigrant capital, and which has incurred the disfavor of many economists worried about the inefficiency and "irrationality" of those rules. A related comparison could have been made between US treatment of Mexican labor and Mexican treatment of US capital. Consider the following aspects:

(a) The Calvo doctrine: It is taken for granted that Turks working in Germany will be subject to German laws and that the Turkish government will act at most as a friend in court if one of its nationals gets in trouble while in Germany. The Calvo doctrine applies fully here, and no one has proposed, as far as I know, special international arbitration tribunals to settle disputes between guest workers and host nations, as in the case of guest capital.

(b) Fade-out rules: Most Western European countries appear to encourage guest workers to go back home after a few years. Few incoming workers are led to believe they can stay forever. Rotation has been a key word.

(c) Discrimination between nationals and foreigners: A few European liberals have proposed the principle of non-discrimination between nationals

and foreigners (expected in the case of capital), in such things as social and job security, access to housing, etc. But in practice, when not in law, the treatment is discriminatory. While during recessions in LDCs foreign investors are more likely than domestic entrepreneurs to have access to credit, guest workers are typically the first to feel the burden of slack demand in Europe.<sup>5</sup>

(d) Discrimination among foreigners according to nationality: This is a practice frowned upon when LDCs use it in the case of guest capitalists. Both de facto and de jure European countries discriminate not only between workers from inside and outside the European Economic Community, but also among those from outside countries.

(e) Consultation regarding the framing and the changing of regulations: Guest capitalists, and often their source country government, will howl if new rules are sprung on them by host governments without previous discussions. The European community commission recently held a conference on migrant workers attended by close to 300 experts, administrators and union leaders. "Perhaps symptomatically, there were almost no representatives there from the migrant workers' organizations themselves."<sup>6</sup>

Even the limited European effort at removing imperfections in the world labor market seems to be running into serious difficulties. Sociological reasons are being brought forth to explain why too high a presence of guest workers leads to difficulties. Thresholds of tolerance beyond which the presence of foreigners becomes unacceptable to the local population are increasingly being referred to. Ugly incidents such as the rash of murders of Algerians in Marseilles (or the murders of U.S. executives in Argentina?) are part of the price of going beyond the thresholds.

The point of the previous discussion is obviously not to suggest that free international migration is the optimal path to worldwide factor price equalization. The purpose has been to highlight the fact that what markets are allowed to operate more or less freely and/or which imperfections receive most attention by both journalists and mainstream social scientists in the rich countries are neither random nor selected by purely technocratic criteria. In a similar vein, the asymmetrical handling by DCs of different types of capital outflow could be explored; while most subsidize their DFI via insurance schemes and tax policies, they hamper free foreign access to their capital markets. In a very imperfect world, the choice of imperfections to decry and tackle is a matter of subjective judgment, often justified on grounds of common sense or "realism." But let us try to be clear as to what usually determines "realism" and whose common sense we are talking about.<sup>7</sup>

Furthermore, the point of the previous discussion is not to argue that the asymmetries in the international economic order will inevitably lead to losses for LDCs; the argument implied that whether or not they gain, or how much they gain, and how much of the burdens of adjustment they are likely to bear, has been a secondary importance to those responsible for setting or changing the rules of the game.

#### V. The Path Toward One World: A Digression

Before taking a closer look at markets for commodities and factors of production, some discussion is necessary on the different perceptions by North and South of concepts of "nationalism" and "internationalism" or

"cosmopolitanism." Those perceptions influence attitudes toward which mechanisms of interdependence should be used among states and toward which markets should be emphasized as arenas of interaction between North and South. Those attitudes are also manipulated by vested interests to obtain their own private ends.

Put briefly, in the North nationalism evokes Hitler, Mussolini, pre-1959 Franco, Enoch Powell and George Wallace. At best, it evokes Gaullist France, although judging from the often outrageous US and UK press treatment of General De Gaulle and his successors, the difference between French nationalism and the others may be perceived as slight. In the South, cosmopolitanism evokes memories of distant foreign Kings or Queens or company presidents with different skin colors, different tongues (or at least different accents) and different cultures. In the North, nationalism was misused not long ago to suppress human dignity, rights of self-determination and cultural heterogeneity. The flag of cosmopolitanism has been used in the South for the same purposes. If patriotism is the last refuge of the scoundrel, cosmopolitanism is the favorite fig leaf of the imperialist.

Before going further, it should be borne in mind that, as in the case of economic conditions, Southern nationalisms are quite heterogeneous. Most LDCs (and DCs) are multiethnic or multiculture states.<sup>8</sup> In some areas, such as Latin America, loyalty to the state overlaps fairly closely with loyalty to the national culture or ethnic group, broadly defined or perceived, while in others, such as in many new African states, strong tensions are likely to remain between different ethnic "nations" or cultural groups brought together under the same state. Without denying the importance of those

tensions, and related language problems, such as those in India, in this paper we will be concerned primarily with the type of LDC nationalism which rallies loyalty to the state as a mechanism to defend the culture(s) and self-respect of LDC peoples, against witting or unwitting encroachments originating in DCs.

Its primarily defensive nature is the key characteristic of this type of LDC nationalism. It is not a matter of promoting loyalty to one's state to suppress other countries, or to brag about being "number one." It is a matter of promoting cultural survival and self-respect. While aggressive nationalism, historically found mainly in DCs, finds a need to create myths about the intrinsic inferiority of other states and nations that it seeks to dominate, defensive nationalism may at worst promote a general mistrust of foreigners, a feeling likely to remain vague and pacific so long as the foreigners do not come into one's own turf trying to dominate.

Hegemonic powers will tend to cloak their nationalism with claims to be promoting internationalisms; in Orwellian fashion they argue that promoting their independence, say of imported oil, will really lead to world interdependence, or will say that proletarian internationalism calls for putting down proletarians with foreign tanks. They often will justify their own nationalistic actions as being taken only after the rest of the world has selfishly and foolishly rejected benevolent hegemonic leaderships; this is the "Noble Siegfried syndrome." The rhetorical excesses of LDC defensive nationalism typically do not include these mental contortions.

Clearly, neither nationalism nor internationalism can be judged as good or bad independently of historical circumstances. Few defenders of LDC nationalism will justify it as an end in itself. Humanity, one hopes,



moves toward becoming one nation, but premature cosmopolitanism imposed by hegemonic powers can be as negative for the march toward that goal as anachronistic tribalism. My hypothesis is that the optimal path for the South, in route to true internationalism, should take it through national self-assertion and defensive nationalism. Even under extremely favorable circumstances, like the case of Puerto Rico, jumping stages (particularly by passive choice) yields ambiguous social and psychological results. Ideologists for multinational empires of all times have sung the benefits to peace and to the economy of suppressing national particularisms, excepting of course those of the hegemonic power. The long run results of such Augustean ages and short-cuts to one world have been so far most unimpressive.

Even within the South, of course, the mystique surrounding the state can be misused. A dominant class, ethnic or cultural group within an LDC can turn that powerful potential engine of growth and integration toward buttressing its own power, or suppressing weaker ethnic or cultural groups. But it would be a mistake to think that nationalism is just the creation of a dominant class or an elite to maintain its power; it goes deeper than that, particularly in states fairly homogenous culturally or ethnically. Another possible retrogressive use of nationalism in the third world involves opposition to regional integration schemes which are potentially favorable for both economic and political reasons in areas without deep ethnic or cultural cleavages. Under those circumstances, some LDC nationalisms can also become anachronistic, and a barrier in the path toward a more efficient defensive nationalism, structured around a larger political unit. But it is not inconceivable that large LDCs may try imposing regional

hegemonies mostly for their own profit, provoking defensive (and healthy) nationalistic reactions from other LDCs against such "premature regionalism." Finally, LDC nationalisms could be manipulated by the North to decrease Third World solidarity.

The subject matter is ambiguous and cannot be settled a priori and, in general, independently of specific circumstances. Put simply, the above discussion suggests that nationalisms should be judged by their promised or realized fruits. In the South, they have enormous potential for raising living standards as well as human dignity and self-respect. That such an instrument can be misused is no argument for throwing it away. Particularly while those historically in the position of leading the way toward the fading away of nationalisms, the DCs, show no sign of doing so.

The ambiguities surrounding the issue of nationalism may explain the wildly different responses evoked, even among scholars, by different historical attempts at "nation building." Contrast, for example, attitudes toward the struggles led by Attaturk and those led by Isabel and Ferdinand. The same observers who are appalled by language riots in India, or tribal clashes in Africa, will often sympathize with the actions of separatist Basques, Ukrainians and Puerto Ricans. And more than one nationalistic intellectual has been taught the value of transnational alliances by a tyrant in his homeland.

One last word on this messy subject. History, especially colonial history, has left us with a crazy-quilt of states and arbitrary boundaries (just look at a political map of the Caribbean!). But one must be suspicious of possible uses of ad hoc arguments pointing to the irrationality

of having a few thousand citizens of country X or Y controlling high percentages of this or that world resource. The suspicion is strengthened by the realization that the DCs, where one often hears that argument, in the past often deliberately helped to create such small or sparsely populated countries, with the excuse of promoting national self-expression. Examples include US involvement in the creation of the Republic of Panama, and British policy in the Persian Gulf. Note that even today the British claim to defend the rights of self-expression of the handful of people on Gibraltar, placed there by the British in the first place, against Spanish claims. Furthermore, having a small percentage of the world's population

controlling a huge share of the production of a given resource does not appear, prima facie, more shocking than similar calculations for consumption of the same resources. Eventually the world community may handle both matters more equitably and rationally; right now the discovery by some in the DCs of the irrationality of existing LDC states and boundaries must be regarded with skepticism and concern.

If the primacy and persistence of desires for national self-determination are granted, we should seek arenas of North-South economic interaction compatible both with LDC goals of greater autonomy, and economic advantage for all participants. Economists have traditionally viewed competitive markets as theoretically capable and reconciling individual freedom with an efficient and interdependent social division of labor. We now turn to examine whether this vision is relevant for contemporary North-South economic relations. In particular, we will want to ask the following questions of actual or potential international markets, besides the traditional ones about their efficiency and competitiveness:

(a) Can transactions be carried out at "arm's-length"? How much will those international economic links intrude into the national social and political life of participants? In short, can arenas for standoffish arrangements be created?

(b) Can international markets provide the goods and services desired by LDCs in separate compartments, or in packages which can be decomposed if the buyer wants a part of them, but not others? Can the LDCs abstain from participating in some international markets, without impairing their chances of becoming effective buyers or sellers in other international markets?

(c) Can international markets provide contracts which have clear termination dates, or which have built-in renegotiating provisions?

In general, of course, the unintrusiveness, decomposibility and reversibility of commercial arrangements will be interrelated. On the whole, the more competitive an international market, the more likely it is that it will have these desirable characteristics.

#### VI. Commodity (Silent?) Trade

Surveying the world trade scene in 1973, it appears that both LDCs and DCs have much to gain from the maintenance and expansion of commodity trade. It also seems that such trade could be carried out in the future in a manner which allows each community a plentiful amount of control over its own economy and society. It can have some of the quality of unintrusiveness anthropologists find in the "silent trade" undertaken between primitive tribes.

That LDCs, particularly the smaller LDCs, may gain a good deal by active participation in international commodity trade would seem to be another obvious proposition, to be taken for granted. Yet it still meets with considerable resistance, perhaps because the proposition in the past was framed in terms of the inevitability of gains from trade to everybody. There was also, and there still is, a good deal of misplaced concreteness attributing to commodities intrinsically desirable or undesirable qualities, e.g., sugar and coffee are bad, butter and steel are good. While such views have some use in understanding the economic history of countries with weak central governments, they are far less useful for many contemporary

LDCs which have a respectable array of policy tools usable to correct distortions and deformations which could arise from staple exports. Note that a recent slogan of the Cuban revolutionary government is: "Sugar for Growth." The historical link between exports of primary products, open economies and landlord-dominated regressive governments can still be seen in several LDCs, and in some countries it may have been strengthened by the 1972-73 commodity boom, but there are now enough counter-examples to show that such link is no iron-law.

Both LDC export pessimists, and those in DCs which delight in convincing poor countries of their alleged economic impotence, not long ago used to argue that imports from LDCs were of marginal importance to the rich, and their purchase was presented almost as an act of DC altruism. Altruism, of course, which could be terminated if LDCs were naughty; witness the elimination of imports of Cuban sugar into the US during the early 1960s and the boycott of Iranian oil in the 1950s. Hypotheses regarding the importance of cheap raw materials and primary products from the South for the prosperity of the North were brushed aside during the late 1950s and 1960s by pointing to small percentages of those imports in gross national product. Arguments about supply reliability were also deemed mistaken or naive: it was all a matter of price, it was noted. Only frantic radicals or third-world types could be expected to take seriously the notion that Northern foreign policies had anything at all to do with assuring those countries with cheap and reliable supplies of primary products from the South. Events in commodity markets during 1972 and 1973, particularly the

oil situation, have shaken those DC perceptions. Indeed, among some DC observers attitudes on these matters have gone from indifference or contempt to a somewhat paranoid hysteria.

The discussion of commodity trade so far has a decidedly old-fashioned flavor; nothing has been said of trade in manufactured goods, billed often as the new breakthrough in LDC exports. For some LDCs, mainly those with a poor natural resource endowment, those exports no doubt offer hope to break out of severe foreign exchange limitations. But it seems far from inevitable or desirable that successful development for all LDCs must be characterized by a sharp increase in the share of manufactures in their export bill. Many can expect to follow a path similar to that of Australia, Denmark or New Zealand, a path in which growing industrialization of productive structure need not be accompanied by a corresponding change in the export bill structure.

From several viewpoints, those LDCs may be regarded as the lucky ones. The luck, in the first place, is in their endowment of natural resources, producing export values which typically include large pure rents, i.e., those exports have low domestic resource costs. One could, of course, have too much of a good thing, if in the very long run excessive rents lead to a flabby society, unable to adapt to new circumstances when the rent-yielding resources become exhausted. Secondly, and regardless of what happened in earlier historical periods, international markets in 1973 for primary products are often more standoffish than those for the new manufactured exports. Placing soybeans, cotton or

copper in international markets will involve less dependent relationships with foreigners than trying to sell internationally Ford engines, parts of Olivetti typewriters or bits and pieces of electronic equipment. The difference is negligible when the comparison is made with steel, cement or flat glass, but excepting textiles not much of the celebrated increase in LDC manufactured exports seem to be in the category of standardized finished industrial goods, sold in open competitive markets. Put differently, LDC comparative disadvantage in international marketing is less of a problem with primary products than with many manufactured exports. Finally, there has been a remarkable trend, which may be deemed basically irreversible, toward LDC control over the exploitation and marketing of those natural resources. Such control, incidentally, may result in more competitive world markets in commodities using those resources as inputs, as LDC nationalizations have diminished the oligopolistic power of several vertically integrated companies. For many LDCs, participation of private and public national entrepreneurs is greater in primary product exports than in those of manufactures.

The dependence associated with exports of many types of manufactured goods would naturally increase if they were to occur only thanks to tariff preferences granted by DCs to favorite LDCs. Under those circumstances, it is not difficult to foresee that the major LDC exports benefiting from such schemes will be those produced by firms owned by citizens of those Northern countries granting special trade preferences. A case can still be made for generalized and unconditional DC preferences granted to all LDCs, but the likely benefits to LDCs from politically feasible schemes of that sort appear out of proportion to the attention they have received during the last ten years.



From all that has been said so far, it should be clear that commodity trade under steady multilateral rules of the game, and in open and competitive markets, is a possible arena of economic interaction between LDCs and DCs offering arrangements which are economically efficient while maintaining desirable characteristics of unintrusiveness, reversibility and decomposibility. Historically, such arena has not existed. Northern countries first developed their LDC sources of primary products under colonial or neo-colonial circumstances, and throughout have manipulated rules of the game in international commodity markets mostly to suit their own ends, not hesitating to change them as their own convenience dictated. Protection to Northern farmers has taken precedence during peacetime over commitments to trade liberalization.

The most recent example of asymmetrical DC attitudes toward international commodity markets is the outcry regarding "freedom of access" to raw materials and alleged "cartelization" by LDCs. During 1953-70, when commodity prices were low or tending to fall, DCs argued that international commodity markets worked best when left alone, including those which even then gave evidence of being either fragmented or far from competitive (diamonds and oil under the ancien régime of the seven sisters). On the other hand, since at least the Second World War, LDCs have argued the case for commodity agreements which would avoid price instability. At first sight, it would appear that this is the right time to resurrect plans for generalized stabilization of commodity markets, giving DCs security about "access on equal terms to the trade and to the raw materials of the world," as put by the Atlantic Charter,

in exchange for assuring LDCs of reliable markets at predictable prices.<sup>9</sup>

The case for a world-wide "ever-normal granary" has been strengthened by the 1973 inflationary pressures, which have baffled the most learned macroeconomists of the industrialized world. In retrospect, and on the basis of a neo-structuralist view of inflation, it can be argued that one of the benefits obtained by the industrialized countries from low or falling LDC export prices during 1953-70, coupled to the reserves generated by US agriculture, was a relatively stable price level. More than a few DC observers are putting their hope for an end of the present inflationary burst on a collapse of primary product prices from their 1972-73 levels. It should not be beyond the wits of a rational world community to devise generalized commodity agreements which, without interfering with long-run price trends, smooth out violent price fluctuations which can trigger inflationary spirals, and provide stocks against natural calamities. Failures of past sporadic commodity agreements could be blamed on lack of political will among participants and on technical weaknesses as much as on intrinsic failings of such arrangements.

It should be noted that even at the purely technical level, it is not clear that a competitive market will generate efficient results for the case of exhaustible natural resources. In an uncertain world, lacking a full set of futures and insurance markets, the market mechanism can become an unreliable means of pricing and allocating those resources, generating myopic decisions and considerable price instability.<sup>10</sup>

So which mechanism is more desirable in the commodity area: imperfect markets or imperfect commodity agreements? Given the medium-term outlook

of demand for LDC commodities, which even discounting the excesses of the 1972/73 commodity boom is reasonably good, I end up leaning toward the former. Unequal LDC bargaining power and interests would make generalized commodity agreements difficult to negotiate, and would present Northern countries rich opportunities to "divide and rule." Outside a few possible special cases, such as oil or copper, LDC bargaining power could best be employed in broadening and improving existing international markets; DC commitments regarding freedom of access to their markets and a gradual end of their protectionism must be the necessary price for their gaining freedom of access to LDC supplies. In some commodity markets, greater use can be made of long-term contracts, as substitutes for missing futures markets. More thought could also be given to improving the latter. Fear of losing access to raw materials has led some DC observers to dream of reviving "special relationships" with selected LDCs; on balance, LDCs have much to gain from multilateral markets free of neo-colonial overtones.

Physical control over a good share of the earth's land surface and subsoil remains the big LDC asset. Notable improvements in LDC political and economic management, plus favorable world market conditions, put many of these countries in circumstances unmatched in their contemporary history, particularly for taking advantage of export growth for local development.<sup>11</sup>

#### VII. Service Transactions

International service markets and transactions, and the characteristics of participants in them, are more heterogeneous than those for commodities. Some are quite standardized, and involve many buyers and sellers dealing at arm's length. Shipping services not controlled by "conferences" approach

such description. Other service markets may be quite competitive, but their geographical domain may be such as to produce interactions between DC and LDC citizens which are not always satisfactory, such as tourism.<sup>12</sup>

A third type of service market, that of technology, or more generally non-academic knowledge, has recently received a considerable amount of attention.<sup>13</sup> The characteristics of the generation of technology or commercial knowledge, and of the product itself, are typically such as to make these markets, particularly those involving DCs and LDCs, far from purely competitive ones.

The market power of DC sellers of technology is buttressed institutionally by the Paris Convention on patents, and by packaging practices of multinational corporations (MNCs), on which more will be said below. The recent upsurge of interest in the economics and politics of technology markets has not yet offset accumulated dismal ignorance regarding their mechanisms. Nevertheless, LDC interest in this area appears fully justified. It is not obvious, for example, that LDCs benefit from the Paris Convention, and a plausible case can be made for the withdrawal of those LDCs which are now signatories. The difficult balance between incentives to generate new knowledge and the efficient dissemination of existing knowledge appears at present overly tilted in favor of the former.

However, national rather than international action should take clear priority in this area. The "knowledge needed to buy knowledge" must be built up by the LDCs as a first step, perhaps in regional associations. Regional development banks, and the International Bank for Reconstruction

and Development (IBRD), could help much more than in the past (the record here is quite bad), but in contrast with the commodity area, and similarly to the field of finance, there is a danger that expansion of international markets and channels of intermediation may weaken indispensable local markets and institutions.

The cruel asymmetry in "knowledge about knowledge" between LDC buyers and DC sellers must be corrected by first building up LDC-controlled expertise and institutions in this area. By now the pool of LDC experts in various fields is most impressive, but due to a lack of indigenous institutions their work within LDCs is often channelled via foreign or international organizations. It is not unusual, for example, to have a DC consultant firm obtain a contract in an LDC to be carried out to a large extent by experts hired by that firm within the same (or in other) LDCs.

Once emphasis is given to developing local expertise and institutions, LDCs would be in a better position to press for reform of international markets in technology, in some cases using their increased bargaining power in commodity markets for that purpose, as some oil exporting LDCs have attempted recently.

Finally, it could be noted that public enterprises of socialist countries, at least in some fields, could play an important role in increasing the flexibility of international technological markets, as presumably they are not as bound by fears of competition used to justify the technological secrecy of developed capitalistic firms. But so far their participation has been timid.

### VIII. International Markets for Labor and Capital

Unplanned international markets for unskilled labor are typically characterized by a sharp division between those who in the host country reap the fruits from a labor inflow, and those who bear the adjustment costs to such an inflow. The gains are often quickly reaped, while the adjustment costs are drawn out and may carry to future generations. This explains mass resistance in most DCs to large labor inflows from LDCs. The ugly racism in which such resistance often expresses itself should not obscure the fact that unplanned international labor flows, such as those in Europe, even when benefitting LDC nationals and DC capitalists, are also an example of premature cosmopolitanism, difficult to generalize massively in today's world. Note that within the South such flows also generate friction; witness the status of Colombian workers in Venezuela and that of Paraguayans in Argentina.

While international markets for unskilled labor are limited and imperfect, the market for skilled labor or human capital has undergone considerable internationalization since World War II. Two-way flows have been established between North and South, often via the intermediation of international organizations. Leaving aside those flows from DCs to LDCs which are explicitly subsidized, the question has been raised as to whether the counter flow from LDCs to DCs, which occurs overwhelmingly as an ostensibly commercial transaction, does not contain a perverse subsidization and resource transfer from the South to the North. A high degree of competitiveness in that market is not in doubt; the issue centers on the appropriability of returns on public investment in education, possible externalities of human capital in LDCs, and the manipulation of markets by DCs using asymmetrical treatment for different types of labor inflows.

Optimal national and international policies in this area, on both economic and political grounds, are likely to exclude both laissez-faire and absolute bans on migration. The numbers involved in these flows are small relative to total populations, and should not generate the frictions associated with mass migrations of unskilled labor to already settled areas. Tax schemes, involving both host and home countries, and known ex-ante to all concerned, could reconcile the legitimate claims of home countries for returns on their public investment in education and individual desire for mobility. Whether such taxes are levied at the time of exit or are spread out through time is a matter which could be settled on practical grounds, with the latter possibility gaining appeal from imperfections of capital markets in an uncertain world. If international taxation treaties have been worked out for physical capital, similar ones should not be too difficult to establish for human capital.<sup>14</sup>

The reader will not be surprised if uncontrolled direct foreign investment carried out by large MNCs owned by DC nationals, particularly those from hegemonic powers, is regarded in this paper as the major example of premature and misguided cosmopolitanism, having most of the undesirable characteristics discussed for arenas of LDC-DC economic transaction. This is not the place to summarize the vast literature of MNCs; a few remarks on the subject should be sufficient.

The relationships between large MNCs and host LDC governments and ruling groups, unless closely controlled and watched, are unlikely to be standoffish in the sense of keeping at a reasonable and decent distance

economic from political decisions. It can be plausibly argued that the same can be said regarding the relationships between MNCs and DC governments and ruling groups. But given the greater frailty of LDC governments and societies, an even greater concern is warranted. Compare, for example, the opportunities for ITT mischief when dealing with the US vs. the Chilean or Ecuadorean governments.

It is well known that MNCs provide a package of services, difficult to untangle and cost separately. The package often can be said to include particular links to the international community, such as participation in the Paris Convention, when a host country is too weak to reject this fashion of signalling its commitment to a favorable investment climate. Local production of some commodities by MNCs can also limit a host country's export potential and even its foreign policy. During 1973 and early 1974, for example, there were reports that G.M. Argentina, Ford Argentina and Goodyear Argentina were waiting for US permission regarding possible industrial exports to Cuba, financed by supplier credits from the Argentine government.<sup>15</sup>

Unless a host country makes a special and often jerky effort, involvements with MNCs are difficult to reverse. Note the difficulties which even well-behaved Canada has had to go through to buy back (at rather handsome prices) an interest in Texasgulf, Inc. Clearly, a marriage so difficult and painful to break up should be entered into only with the greatest of circumspection. The Romanian publication of its detailed "marriage" contract with Control Data, said to include 29



appendices, in its official gazette, is an example which LDCs should consider following.<sup>16</sup> Whenever possible, of course, such LDC actions should be adopted under common rules, to expand their bargaining leverage, in the spirit of the Andean group.

The tendency of MNCs to interact negatively with LDC market imperfections and to replace both national and international markets for internal corporate planning explains why some market-oriented economists express serious reservations about their role in LDCs. Consider the following two statements, one by Hla Hyint and the other by Ronald McKinnon:

"But it may be wondered whether, instead of their current policies of protection and selective admittance of foreign manufacturing industry, they [the LDCs] might not find a more promising 'second-best' policy in combining restrictions on all foreign enterprises with free trade."<sup>17</sup>

"Correspondingly, the bootstrap theory here implies that reliance on foreign direct investment--with its package of finance, modern technology, and managerial skills--should be curtailed by LDCs themselves in order to promote balanced indigenous development."<sup>18</sup>

That DFI carried out by large MNCs, particularly those with headquarters in hegemonic powers, often tend to replace markets and have a number of undesirable political and social effects, does not rule out the possibility that such agents frequently will turn out to be economically more efficient than the uncontrolled markets they replace. Centralized planning, either public or corporate, may improve on uncontrolled market performance, both theoretically and in practice. Indeed, some popular

criticisms of MNCs in the North relate not to their monopolizing tendencies, but to the burdens of adjusting to MNC actions which essentially reproduce what competitive markets would yield, but more brusquely and perhaps faster, as in the case of transferring labor-intensive production from high to low-wage areas.

It should also be noted that even if the DFI package could be totally untangled, many LDCs will still prefer at least some amount of packaging, preferably in the form of joint ventures, as a way of insuring continuous access to the on-going technological research of foreign companies. Such deals will be healthier, however, when chosen over other options, especially the one of total unpackaging, as contrasted with their reluctant acceptance as the only possible way to obtain technology and capital.

There is, of course, no economic reason why international capital movements should occur solely or primarily via MNCs. Before the great depression of the 1930s, large sums were transferred from DCs to LDCs using debt instruments via capital markets which were no models of perfect competition, but which allowed greater flexibility, in many respects, than direct foreign investment. Technology, on the other hand, was transferred massively and largely independently of those capital flows. Influenced by the unfortunate experience of the 1930s, Anglo-Saxon

planners sought to replace those markets in the post World War II new order partly by institutions such as the IBRD, for long-term capital, and the International Monetary Fund (IMF), for short term capital. The MNCs also stepped into the void, becoming not only investors of their own funds, but also acting as financial intermediaries, borrowing in DCs and in LDCs to invest within LDCs.

Many DCs emerged from the 1930s and the second world war with formal and informal regulations limiting foreign access to their national capital markets. Not surprisingly, and until very recently, international capital markets worthy of that name remained thin and lethargic, shackled by restrictions and dominated by the competition from MNCs, the IBRD and the IMF.

The remarkable upsurge during 1972/73 of LDC medium-term borrowing in the unregulated Eurodollar market, so far mostly in the form of bank loans, could signal a revival of the use of international markets to transfer capital from DCs to LDCs, as well as their use of intermediaries for capital flows within the LDC group. Without underestimating the danger that international capital markets could show increasing cartelization, nor that their expansion could jeopardize the development of those within LDCs, it nevertheless appears that transactions in the Eurodollar market between DC private institutions and LDC borrowers show characteristics of unintrusiveness, decomposibility and reversibility to a much greater extent than those involving MNCs. The list of borrowers include countries such as Algeria, Cuba, Hungary, Peru and Yugoslavia, which have not been favorites of MNCs. The Peruvian example may be particularly significant,

as much of that country's borrowing took place while the World Bank, the Inter-American Development Bank, and of course AID, engaged in an informal financial blockade, following Peruvian nationalization of some direct foreign investments.

It is significant that this trend has not met with universal acclaim. This partly reflects a legitimate concern for the fragility of the Euro-dollar market and for the dangers of excessive borrowing by LDCs. But one also detects in some of the worried commentary a touch of the fear of the intermediary who is being cut out, and of the bureaucrat who is losing control and power. Others actually prefer a tied package to markets providing each component separately. Some of these attitudes may be reflected in the following quotes from a recent speech by William S. Gaud, executive vice president of the International Finance Corporation:

"Nevertheless, I see very real risks for the developing countries in borrowing so heavily in a market with no established lending standards and no overall surveillance to prevent unsound practices. . . . There is another feature of these Euro-currency loans which should not be overlooked. Foreign private investment is important to the developing countries not only because it contributes capital for their development but because it brings with it technology, management, training and access to foreign markets-- items which are all in short supply in the Third World. Euro-currency loans bring with them none of these. Indeed, they are often made even without any appraisal of the soundness of the projects they are intended to finance."<sup>19</sup>

Suitably extended and reinforced, on which more below, a reasonably competitive international (private) market for LDC debt can provide a useful arena for economic interaction between DCs and many LDCs. This is the path of independence and a minimum of controls, as put by Charles P. Kindleberger in his pioneering advocacy of this thesis.<sup>20</sup> But the LDCs committed to a market economy would do well to expand also their own internal capital markets. The richest and more sophisticated LDCs can also increasingly take a bigger share of the profits from intermediation by developing their own financial institutions, capable of operating at the international level, particularly for flows among LDCs (and a fortiori for flows among nationals of the same LDC).

#### IX Concessional Finance

The two arenas singled out as particularly favorable for DC-LDC interaction, i.e., commodity and debt markets, even if working well may leave the population of the least developed countries, devoid of much of a natural resource base and therefore not creditworthy by current commercial standards, in extreme poverty for the foreseeable future. These countries provide the strongest argument for the continuation of international concessional financial flows, which otherwise share with direct foreign investment low grades in standoffishness, although doing somewhat better in decomposibility,<sup>21</sup> and much better in reversibility or ability to terminate the arrangement relatively smoothly.

It may be possible that international concessional finance going to the least developed countries will include in the future the participation

of other, more prosperous LDCs, particularly in regions with a strong sense of cultural solidarity, such as Latin America and the Moslem nations. Be that as it may, aid to the least developed countries will be more successful when targetted to a clearly defined charitable purpose, like avoiding a famine, than when seeking more general goals, i.e., promoting development. This, of course, will not surprise those who have followed the aid story during the last twenty years.

The orders of magnitude for concessional finance which realistically can be expected during the foreseeable future do not warrant much discussion of this form of DC-LDC interaction. Looking back, it is clear that the attention given by academics and others to this area was out of proportion to its actual or potential importance for development in most LDCs.

The soft windows of existing multilateral institutions, such as the IBRD-IDA and the regional development banks, are likely to continue limping along undramatically, except in the unlikely case that they were to receive large and steady funds from SDR-link schemes, from oil-rich states, or from controlling seabeds. Those institutions will have to rely mainly on their usefulness as intermediaries between world capital markets and LDCs which find direct access to those markets too expensive, or which prefer, for a variety of reasons, to place part of their debt with multilateral institutions. The greater variety of possible sources of finance open to the more advanced LDCs will no doubt put some competitive pressure on the World Bank group and on regional development banks. Such pressures may lead to difficult dilemmas

for those institutions: viewed as organizations wishing to survive and expand or desiring to influence domestic LDC policies, they will want to woo their "best customers," such as Mexico, Nigeria, Brazil and Thailand. But from a development viewpoint, they should consider charging higher rates of interest to their best customers (who may then stop borrowing from them), while passing on to the poorest countries via lower interest rates all of the gains obtained by public multilateral borrowing.

The influence which bilateral or multilateral aid agencies will be able to exert on the domestic priorities of borrowing countries will continue to wane for those LDCs with alternative borrowing possibilities. Regardless of the good intentions of those attempting to guide LDC priorities, or of the wisdom of whichever happens to be the fashionable top priority at a given time among world development executives, the experience of the last ten years suggests that such waning is mostly to the good. Whatever the levels of concessional bilateral or multilateral aid which remain to be granted in the future are, they would best be disbursed quietly and routinely, with a greater sense of automaticity and without too much involvement in other countries' domestic affairs.<sup>22</sup>

#### X. International Monetary Reform

One major LDC interest in international monetary reform, narrowly defined, is to obtain the scheme most favorable to smoothly expanding world trade in a multilateral framework. On this point all LDCs, large and small, as well as DCs, appear to agree. One can go further and suggest that as most LDCs are (and are likely to remain for a long time) net debtors, they will benefit from a system yielding a world aggregate demand such that it

induces a mild inflationary trend in the world price level, a trend which will hopefully not be fully anticipated by lenders. A rising world price level resulting from cost-push forces in the industrialized world, particularly if accompanied by slack capacity utilization in those countries, however, is unlikely to be accompanied by external circumstances which are on balance favorable for LDCs.

A relatively flexible exchange rate system, with rules for crawling or wiggling, among industrialized countries and large and/or inflationary LDCs seems most suitable to the maintenance of full capacity use and expanding world trade. It is at first sight somewhat surprising that LDCs as a group, a group within which small LDCs have the most votes, have supported fixed rates for the DCs. The explanation, however, seems straightforward. Economically small and open LDCs, small and open with respect to both trade and finance, will usually want to maintain fixed parities vis-a-vis a major industrial power, for optimum currency area reasons, whatever the world exchange rate system is. Thus, Guatemala will want to keep its currency pegged to the U.S. dollar, Chad will wish to peg to the French franc, etc. Note that even large Mexico wishes to remain pegged to the U.S. dollar. Given such a starting point, it is not surprising that those LDCs will prefer the major currency to which they peg to remain in turn pegged to the rest of the world, particularly when their trade, although oriented toward one industrial power, has a reasonable degree of geographic diversification. This will not only maximize the economic benefits derived from optimum currency area considerations, but it will also cloak the unpleasant neo-colonial flavor of being in a dollar area, a franc area, etc. A world without an obvious



single international money also presents a number of minor headaches for managers of LDC external asset and debt portfolios. Finally, it can be argued that as LDCs wish to expand the amount of SDRs issued, even under present rules, they will naturally oppose exchange regimes which would reduce the need for international reserves.<sup>23</sup>

The gross loss to small (and not-so-small) LDCs of having the industrialized countries move to more flexible exchange rates, however, may be in fact turned into a net gain when one compares that scenario not with the pre-1971 world, but with realistic alternative monetary arrangements for the future. A future system of pegged rates among industrial countries is unlikely to work without severe controls over trade and capital flows, or without a close and cozy degree of policy coordination among DCs. Neither prospect should be particularly attractive to LDCs, which may not escape even under a formally fixed exchange rate system the dangers of hegemonic currency areas and preferential zones. In spite of the image projected by official declarations, this is in fact recognized by many LDC policy-makers.

Contrary to some panicked commentary, the LDC experience in the post-1971 world has been, so far and on balance, quite good, and many an LDC Central Bank has learned that it is not so difficult to keep tabs on cross-rates or to calculate reasonable portfolio combinations in different currencies. While granting that the extraordinary 1972/73 commodity boom has helped adjustment to the new order a good deal, it must also be pointed out that forces fuelling that boom, including fiscal and monetary policies in the North, were encouraged by the new floating policies. It may also be noted

that while flexible rates in major financial centers are supposed to discourage, ceteris paribus, international capital flows, the post-1971 world has witnessed a large expansion of LDC activity in those markets.

In short, a world trading community with low and decreasing DC controls over commodity and capital flows, with expanding trade, and with loose policy coordination among DCs is difficult to visualize without the adoption by those countries of reasonably flexible exchange rates. Such a system, while providing LDCs a potentially favorable external environment, will impose some minor adjustment costs to many of them. A weak case could be made for compensating them for such costs via more favorable allocations of Special Drawing Rights (SDRs).

On the assumption that major industrial countries will consolidate a system of floating exchange rates, while most non-inflationary and small LDCs will keep fixed rates in terms of one of the key currencies, it can be argued that the reserve needs of the latter will be greater than those of the former, relative to their shares in world trade.<sup>24</sup> Participation in SDR allocations, and perhaps IMF quotas, could be expected to adjust to this new situation. It could also be expected that the rules for crawling which may emerge from international monetary reform will make allowances for the different characteristics of LDC balance of payments situations, rather than rigidly trying to apply the same rules to all, regardless of serious structural differences. For example, a net debtor can be expected to keep a level of gross international liquid reserves different from those of a net creditor. LDCs exporting exhaustible natural resources may, in their optimization plans through time, accumulate large liquid reserves in the

near future, to be drawn down at a later date. Rigid rules built around reserve levels, or even changes in levels, would neglect those special circumstances.

A tactical decision for LDCs as a group has been whether to seek to broaden negotiations for a new international monetary order into a more general discussion of international economic reform, in the spirit of 1944, and if so, on which related issues to concentrate their bargaining power. So far, the LDCs have chosen to emphasize plans for a link between SDR creation and a favorable allocation to LDCs. Such proposals have run into serious opposition. At bottom, the non-academic opponents are unwilling to yield DC political control over the grant element which would be involved in link schemes. At the same time, however, and mainly for technical reasons, the idea that SDRs should bear an interest rate not too far below those ruling in the world markets for prime short term paper has gained ground. This implies that net users of SDRs would gain less net real resources even from favorable allocations. The use of SDRs would then become an attractive form of borrowing for LDCs, particularly to those with weak international credit standing, but not that different from other forms of borrowing.

It may well be that a reallocation of IMF quotas and SDR allocations, justified primarily by generalized floating by industrial countries plus widespread pegging by LDCs, and the recognition of special LDCs balance of payments problems, with greater quotas and SDR allocations going to the LDCs, is all that can be expected at the moment. This, of course, could be made to yield some net gains to LDCs as a group.

There are other issues of international economic reform where LDC bargaining power could be fruitfully applied under present circumstances. Reduction of DC protection for commodities of special LDC export interest, and the removal of DC practices restricting the diffusion of technological knowledge have been already mentioned as candidates for discussion.

An important area which has been neglected so far in international monetary discussions is the establishment of liberal and clear rules guaranteeing LDC access to the national capital markets of industrialized nations. This may be partly explained by the boom in LDC borrowing in the international Eurodollar market. But the lesson from that experience is then not being correctly learned. Such boom does show that very large sums, estimated at around \$8 Billion in 1972 and more in 1973, can be mobilized by LDCs with a minimum of strings, via international capital markets. There is, however, some truth to the criticism that the Eurodollar market is still a fragile and limited capital market. For example, LDC borrowing has been heavily in the form of bank loans with maturities of not much more than 10 years and with floating interest rates; the market for long-term LDC bonds has not expanded very much yet. The continuity of these flows is far from assured.

It is time to consolidate LDC advances in the Eurodollar market by extending them to the national capital markets of DCs. Restrictive rules on DC imports of LDC debt paper, inherited often from the 1930s, have survived almost intact, even as the corresponding rules for commodity imports were gradually liberalized during the post-war. Those restrictive

rules may sometimes appear not to be binding simply because the discouragement they signal precludes the actual testing of the limits they impose. Frequently, the rules on debt imports are not just restrictive, formally or informally, but also discriminatory. Thus, in some DC national capital markets only favored LDCs, usually ex-colonies, are allowed to place their debt papers. At a time when international monetary reform is being discussed, certainly these are matters which deserve a close review by DCs and LDCs. The payoff could be substantial, not only in increased capital availability to LDCs and lower borrowing costs, but also in decreasing the political frictions associated with other forms of capital transfer between DCs and LDCs. Possible large financial surpluses of some oil-exporting states support the need to develop and strengthen world financial markets.

It could be argued that easier access to external capital markets will only benefit large, resource-rich LDCs, with a diversified or very lucrative export bill. However, even small, undiversified LDCs have been borrowing in the Eurodollar market. Furthermore, smaller LDCs could band together to enter international capital markets, as the relatively poor Central American countries have done. In some cases, more prosperous LDCs could guarantee the debt instruments of less fortunate LDCs. Regional and sub-regional development banks could be used as instruments in these activities, in the same fashion that similar institutions could be used by small and medium size LDCs to handle their joint search for, and purchase of, foreign technology. Organizations would thus be created or strengthened to improve the conditions of access to world markets by the smaller LDCs, institutions

which could be turned around to accelerate commercial integration within the group if world market circumstances turned adverse. Had Latin America developed such institutions during the 1920s, its crash industrialization programs during 1930-1945 would have been probably both more ambitious and rational.

LDCs committed to a mixed domestic economy plus active links to world commodity and financial markets will find a growing need for sophisticated management in their fiscal, monetary and exchange rate policies. While those world markets during the 1970s have opened up new options for LDCs, they also limit freedom of action regarding the use of domestic policy instruments. The kind of free-wheeling experimentation with domestic policy tools which many mixed economy LDCs underwent during the 1950s has now become riskier and potentially costlier.

## XI. A Few Final Remarks

This paper has been written around two basic working hypotheses, one political and one economic. The former assumes a multipolar world, with several major centers of political and military power, all limited in their hegemonic pretensions by the nuclear stalemate. Out of such political underpinnings, relatively free international markets could provide a plausible mechanism for interdependence among the citizens of different states. The basic economic hypothesis, which has a somewhat neo-Leninist flavor, is that for the foreseeable future the North will have a substantial and growing excess demand for Southern commodities, mainly but not exclusively for primary products, plus an excess supply of finance capital, a supply which could be enlarged by the surplus funds of some oil-rich LDCs. The North can also be expected to maintain an excess supply of new technology and capital goods. Handled via relatively open international markets, those circumstances can yield gains for all participants.

Much of this, of course, is already happening. But those markets are still quite imperfect, and will always be at the mercy of political decisions regarding whether and how they will be allowed to operate. Those in LDCs and DCs interested in obtaining both economic efficiency and national autonomy would do well to use whatever bargaining power they have to strengthen those markets. The Southern countries are not without bargaining strengths, and can be expected to use them with increasing sophistication to achieve less asymmetrical international economic relations. Their potential bargaining strength arises not only from

conflicts among the Northern countries, but also from clashes of interest among different groups within industrialized states.<sup>25</sup>

Besides concessional aid to the poorest LDCs, there will remain some areas of economic interaction between DCs and LDCs where it may be difficult to even imagine the operations of decentralized markets, and where political decisions will have to be quite open and explicit, often involving the creation of supra-national authorities to regulate economic activity. An obvious example involves the economic use of the commons of mankind, particularly the seas and the seabed assets for which nobody has ownership titles. The only alternative to an explicit political settlement in this area, where potentially large pure rents are up for grabs, is a de facto or de jure enclosure movement using technological, political and military power.<sup>26</sup>

Leaving aside difficulties associated with non-appropriated resources, it is perhaps worth emphasizing that one should not exaggerate the ease of obtaining, even granting political willingness to do so, efficient, stable and competitive world commodity markets, particularly for exhaustible natural resources. Notions of different discount rates, intergenerational equity, conservation and inevitable uncertainties about future technologies greatly complicate the picture, heating up the scramble for control of large rents. If, as in the case of oil, sellers of those commodities generate surpluses, for which investments with small risk and reasonable returns are difficult to find without the cooperation of commodity buyers, the tangle becomes monumental, even if producers and buyers were many and competitive. Some politization of these markets may thus be inevitable, except perhaps in a world where natural resources were evenly divided among 350 countries having 10 million inhabitants each.



More generally, it is difficult to visualize any future international community with even minimum claims to legitimacy and fairness which would exclude LDCs from negotiations settling worldwide economic matters either directly or by establishing market rules of the game. Full LDC participation in international trade and monetary reform discussions, even if it spoils past clubby atmospheres,<sup>27</sup> should thus be regarded not as an absent-minded concession by DCs, but as a first step toward full LDC participation in world economic planning.

#### FOOTNOTES

\*An earlier draft of this paper benefitted greatly from criticisms received during a conference held at the Brookings Institution on January 10-12, 1974. Detailed comments from C. Fred Bergsten, Benjamin I. Cohen, Richard N. Cooper, William Diebold, Jr., Gerald K. Helleiner, Albert O. Hirschman, Lawrence B. Krause, Charles P. Kindleberger, Vahid Nowshirvani and Gustav Ranis are also gratefully acknowledged. Many of the ideas in this paper were either picked up from the work of Stephen Hymer, or were developed as a reaction to his stimulating thought. This paper is dedicated to his memory.

<sup>1</sup>See, for example, Simon Kuznets, Modern Economic Growth, New Haven: Yale University Press, 1966, and Hollis B. Chenery, "Alternative Strategies for Development," paper presented to the Rehovot Conference on Economic Growth and Developing Countries, September 1973.

<sup>2</sup>This paragraph paraphrases William R. Cline, "Income Distribution and Economic Development: A Survey and Tests for Selected Latin American Cities," paper prepared for ECIEL International Conference on Consumption, Income and Prices, Hamburg, October 1973, p. 50.

<sup>3</sup>As put by Premier Chou En-lai, in his report to the 10th National Congress of the Chinese Communist Party:

"They content as well as collude with each other.

Their collusion serves to the purpose of more intensified

contention. Contention is absolute and protracted, whereas collusion is relative and temporary."

New York Times, 1 September 1973, p. 6.

As an example of what the cartelized world would look like, consider the following remarks of Mr. Harold Geneen, President of ITT:

"What these countries [the LDCs] need most are long-term investments. If our government is not going to support us, there is going to be less investment. The answer may be a multinational approach. By this I mean the Germans, the Swiss, the World Bank, and others share in the investment. Then six countries are involved, not one. If something goes wrong, the countries can get tough and do things. You don't go to war, but maybe everybody refuses to give the offending country credits."

Business Week, 3 November 1973, p. 44.

<sup>4</sup>"To achieve efficiency in world production it is unnecessary that both commodities and factors move freely . . . If it were not for the problem of transporting interest payments . . . one mobile factor will be sufficient to ensure price equalization." Robert A. Mundell, International Economics, New York, The Macmillan Company, 1968. p. 95. In this barter model interest is paid in the form of commodities.

<sup>5</sup>Some have argued that this last statement exaggerates the adjustment burden borne by migrant workers already residing in Western Europe, claiming that changes in the demand for labor are mainly reflected in the

gross inflow rate of fresh guest workers. Nevertheless, a real burden remains. The Economist of London reported in its issue for 26 January 1974, p. 43, in a story entitled "Holiday at Your Peril," reluctance among Turkish workers in the Federal Republic of Germany of returning home for new year holidays, for fear of being fired while they were away.

The report added:

"...how do the foreign workers, who make up a tenth of the German labour force, feel? Very frightened indeed...

The way to protect German workers, and at the same time avoid paying out millions of marks in unemployment benefits, would seem to be to encourage a million or so foreigners to go home. The problem is how.

One idea that has been kicked around...is that the foreign workers should be given a departing financial handshake... Other, cruder, methods are rather more effective. At local level, a wink from an employer to a local authority can result in the non-renewal of work and residence permits. Or accommodations that used to be considered acceptable can suddenly become 'uninhabitable'."

<sup>6</sup>The Economist of London, 9 February 1974, p. 48. The same article reports that Germany plans an outright ban on further guest-workers hirings in cities with an immigrant population of more than a quarter of the total, a kind of crude rule-of-thumb restriction much lamented when imposed by LDCs on DFI.

<sup>7</sup>In an article informing readers on the editorial page of The Wall Street Journal, 13 December 1972, p. 22, that "the relations among nations are governed by a few fragile covenants which we call international law, by some vague consensus of world opinion which we call international morality and, above all, by common sense," the Henry Luce Professor of Urban Values at New York University, Dr. Irving Kistol, goes on to say:

"Gunboats are as necessary for international order as police cars are for domestic order. Smaller nations are not really worried about American atom bombs any more than the Mafia is. And smaller nations are not going to behave reasonably--with a decent respect for the interests of others, including the great powers--unless it is costly to them to behave unreasonably."

<sup>8</sup>See the stimulating article by Walker Connor, "Nation-Building or Nation-Destroying?", in World Politics (April 1972), pp. 319-355. He charges that theoreticians of LDC nationalism and "nation-building" have slighted problems associated with ethnic diversity. One could speculate that in the same fashion economists have sought to define optimal currency areas, political scientists could attempt defining optimal nation-states, bearing in mind ethnic diversity, which plays the role of factor immobility in limiting larger optimal areas.

<sup>9</sup>The Keynes plan for commodities, recently unearthed from British archives by Dr. Lal Jayawardena and to be published in a forthcoming issue of the Journal of International Economics, deserves at least a fresh look

in discussions about a new international monetary and economic order. The second draft dated December 1942 opens by referring to the fourth point of the Atlantic Charter, quoted above. Note that the Keynes plan coupled "freedom of access" for DCs to "freedom of sales" at predictable prices for LDCs, a point ignored by most DC observers and officials. In his original draft, Keynes starts by calling for the internationalization of Vice-President Wallace's "ever-normal granary." I recently heard a brilliant mainstream US political economist justify US bans on its wheat exports; he went on to argue that wheat sales should only be permitted to foreign countries willing to sign long term purchase agreements. He was clearly surprised by, and failed to answer, a question as to whether he also advocated long term contracts for US purchases of primary products. It is not without certain irony that the same officials who not long ago turned down Venezuelan requests for greater access to the US oil market now complain of unreliability of foreign oil supplies. It is also ironic that as late as September 13, 1973, The New York Times, p. 71, reported attempts by US diplomats to organize a boycott of Libyan oil.

<sup>10</sup> See William D. Nordhaus, "The Allocation of Energy Resources," Brookings Papers on Economic Activity, 3: 1973, pp. 529-571. Using energy as an example of exhaustible resources, and noting that besides the basic economic problems (lack of futures markets, uncertainty about future technology, etc.), political interference is also present, Nordhaus remarks:

"It takes an act of faith to believe that "the market"  
can somehow see the proper allocation through this tangle

of complexity, uncertainty, and politics" (p. 538).

<sup>11</sup>The improvement of LDC foreign trade policies by itself cannot be expected to provide automatically in all countries substantial help in achieving development targets, beside faster growth, not related directly to the foreign trade sector. For example, export promotion policies may in some countries hurt equity in income distribution (by much or little), while helping equity in others (by much or little). Neither qualitative nor quantitative generalizations appear warranted regarding the link between trade policies and income distribution. The problem, relevant also for DCs, is that different positive theories of trade have different implications for income distribution and, therefore, for political attitudes toward freer trade. If one believes, for example, that the key source of comparative advantage for a given country is a large endowment of capital to labor, one will expect all capitalists to be pro-trade biased as compared to all laborers. But if the key source of comparative advantage is best explained by research and development in new products, industries leading in that field will be the main champions of freer trade.

<sup>12</sup>In passing, it may be noted that tourism is made more palatable to host countries by the application of the Calvo doctrine to foreign guests. The occasional injustices suffered by DC tourists at the hands of unscrupulous LDC officials abusing the Calvo doctrine has not led to many calls for international arbitration tribunals, as far as I know, but to some passable popular songs, like Tijuana Jail. Nevertheless, it should be noted that alleged fears for the lives of DC nationals happening to be visiting

a given LDC going through acute political turmoil, have been used as excuse to land DC "guest troops" (without visas or tourist cards) into LDCs.

<sup>13</sup> See, for example, Constantine Vaitsos, "Transfer of Resources and Preservation of Monopoly Rents," mimeographed, April 1970; Jorge M. Katz, "Patents, the Paris convention and less developed countries," Yale Economic Growth Center Discussion Paper No. 190, November 1973; and Edith Penrose, "International patenting and the less developed countries," The Economic Journal, September 1973, pp. 768-86.

<sup>14</sup> Jagdish Bhagwati and William Dallalfar have advanced a concrete proposal along these lines in their paper, "The Brain Drain and Income Taxation: A Proposal," Working Paper No. 92, M.I.T. Department of Economics, September 1972.

<sup>15</sup> See Business Latin America, 12 December 1973, pp. 393-394. Canadian subsidiaries of US-owned firms have also been plagued by this issue. Recently, a Canadian political leader asked:

"On what basis is it necessary for the Canadian Government to request the intercession of a foreign government in an export deal between a Canadian company and some other company?"

The New York Times, 6 March 1974, p. 47. Some hope exists that the US will finally decide to end its extraterritorial claims on foreign subsidiaries of US-owned firms during 1974.

<sup>16</sup> See report in Business Week, 8 December 1974 ("A Warm Hand for US Business"), pp. 24 and 27. The Wall Street Journal reported on 30 August



1973, p. 8, that Senator Lloyd Bentsen of Texas had personally appeared in court to express his reservations about the Canadian attempts to purchase Texasgulf, Inc.

<sup>17</sup>Ula Myint, "International Trade and the Developing Countries," in P. A. Samuelson, editor, International Economic Relations, Macmillan, London, 1969, p. 35.

<sup>18</sup>Ronald I. McKinnon, Money and Capital, The Brookings Institution, Washington, D.C., 1973, p. 172. Both Myint and McKinnon refer favorably to the Japanese experience during the Meiji period.

<sup>19</sup>William S. Gaud, "Private Investment and Local Partnership," speech at a Financial Times conference on the European Community and the Third World, 7 November 1973, pp. 2-4. The same speech notes the sensitivity of the Euro-currency market to speculative waves, and the difficulty of planning investments under the Eurodollar regime of floating interest rates. It should be noted that Mr. Gaud recognizes positive feature in LDC Eurodollar market borrowing.

<sup>20</sup>See Charles P. Kindleberger, "Less Developed Countries and the International Capital Market," in Industrial Organization and Economic Development, In Honor of E.S. Mason, edited by Jesse W. Markham and Gustav V. Papanek, Boston, Houghton Mifflin, 1970, pp. 337-349. See also Richard N. Cooper and Edwin M. Truman, "An Analysis of the Role of International Capital Markets in Providing Funds to Developing Countries," Weltwirtschaftliches Archiv, June 1971, Number 2, pp. 153-182. It should be clear that interna-

tional bankers must not be credited with extraordinary angelic virtues, and LDCs must be on guard to prevent 1920s-type abuses arising from high pressure salesmanship, more recently associated with suppliers' credits.

<sup>21</sup>Aid, particularly bilateral aid, is likely to be tied not only to commodities from the donor country, but also to accepting donor country's direct foreign investment. As expressed by the US Secretary of the Treasury, Dr. George P. Schultz:

"Every sovereign nation has, of course, the right to regulate the terms and conditions under which private investment is admitted or to reject it entirely. When such capital is rejected, we find it difficult to understand that official donors should be asked to fill the gap."

The New York Times, 26 September 1973, p. 5.

<sup>22</sup>This viewpoint is eloquently presented by I.G. Patel, "Aid Relationship for the Seventies," in Barbara Ward et al, Editors, The Widening Gap; Development in the 1970's, (New York: Columbia University Press, 1971), pp. 295-334. See also Albert O. Hirschman and Richard M. Bird, "Foreign Aid--A Critique and A Proposal," Princeton Essays in International Finance, No. 69, July 1968.

<sup>23</sup>See Gerald K. Helleiner, "The Less Developed Countries and the International Monetary System," Journal of Development Studies, forthcoming during 1974. Some LDCs, confident in their resources and macroeconomic management, may consider that disturbances are more likely to arise outside than inside their economies, and therefore will use changes in their exchange rate to shield themselves from inflation coming from the industrialized world. For example, Venezuela has revalued its currency with respect to the dollar in recent years for this purpose.

<sup>24</sup>Inflationary LDCs, i.e., those whose price levels rise chronically at a faster rate than the world price level, or that of the major industrial country to which they would otherwise peg, may also have a legitimate claim to larger reserves if all their crawling pegs achieve is the elimination of the difference in inflationary trends, without seriously smoothing out other sources of balance of payments disturbances, which may remain virulent in those countries.

<sup>25</sup>On this point see the outstanding document presented by Tanzania to the Lusaka conference of nonaligned states, Cooperation Against Poverty, Dar es Salaam, Government Printer, United Republic of Tanzania, 1970.

<sup>26</sup>Those confident of their technological and military muscle are calling for just that. The Wall Street Journal, 17 December 1973, p. 14, has editorially suggested that the US should withdraw from the UN Law of the Sea conference, in the following terms:

"Enough is enough. For the sake of form, the United States may as well send its negotiators to Venezuela and Vienna, though there is much to recommend a clean break. But the important thing is that the US government should free the petroleum and mining industries of any caveats linked to some future treaty, and let them go to work adding to the world's store of available resources."

<sup>27</sup>On September 21, 1973, The Wall Street Journal, p. 12, reported from Nairobi that:

"For all their old complaints, though, officials of industrial countries now find it difficult to suppress

their longing for the days when they could meet without having to share every secret with, or explain every technicality to, the Tanzanians and Chileans."