CHAPTER 5

BROADER HORIZONS

5.1 ONE WORLD OR NONE: THE NEED FOR WORLD AIMS

In Part I we tried to isolate and analyze the main sources of tension in today's world economy. We found that these could be grouped under the following categories:

(i) the underdevelopment of a large part of the world;
(ii) competition between different economic systems;
(iii) the passing of colonialism;
(iv) economic instability, especially in primary markets; and
(v) national shortsightedness, especially in trade policy.

Underdevelopment was considered to be the main problem, and the other problems were discussed in relation to this central issue. In Part II we will attempt to suggest a coherent international economic policy. The world problems involved are closely interrelated and will not necessarily be dealt with one by one.

We must bear in mind that economic policy is formed at many

levels in many countries and international bodies, and that it is interwoven with policies directed at noneconomic aims, such as power, security and many lesser objectives. The motivations of nations are based largely on traditions and historical facts, and they differ widely. Even if it is intellectually clear that important changes are needed, inertia must be reckoned with. The best we can hope for is that political activity can be more systematically directed at the urgent goals of today, that it can be streamlined and made more consistent. In this part of the book we will often suggest what seem to us to be ideal policies or institutions. Nobody could expect these suggestions to be carried out immediately. They may, however, serve as a guide for policy-making at various levels in the longer run. It is the task of the economist to make clear what is the best technical solution to an urgent problem, even if that solution seems at the time "politically impossible." Political opinion is not invariable, nor entirely autonomous; it can be changed by economic arguments, if only with some delay.

This chapter will discuss the principles which should inform a consistent set of policies; it will be a reasoned plea for as broad a point of view as possible. Our attitude may be summarized by the assertion that we can no longer afford the luxury of national autonomy. With regard to security we have already accepted the truth of the warning, "One world or none." We must accustom ourselves to the same idea with regard to economic conditions. Economic policy should serve the ends of the world at large — or, if agreement with the Communist bloc cannot be reached, the ends of the non-Communist world.[1]

We may begin our argument by reminding the reader of past experience with autonomous national policies, economic as well as other. Early in the 20th century, world affairs depended upon the interaction of the national policies of a small number of powerful nations. In economic terminology it was a game of oligopoly. As

1. On this subject see H. W. Singer ("Trends in Economic Thought on Underdevelopment," *Social Research,* Winter 1961), who in addition quotes Arnold Toynbee to the effect that ours is the "first age since the dawn of civilization, some five or six thousand years back, in which people dared to think it practicable to make the benefits of civilization available for the whole human race."

such it had no stable solution, but resulted in a series of conflicts of which World Wars I and II were the most momentous. To be sure, these conflicts were not solely economic, but economic forces played an important role. More recently social factors have become more important — on a national and an international level — but social and economic factors are intimately linked.

Besides contributing to wars and colonial conflicts, economic nationalism severely aggravated the economic difficulties of the thirties, as was pointed out in Chapter 4. During the great depression governments tried to solve their difficulties by measures damaging to other countries' interests, such as trade restrictions and devaluations, instead of adopting a common anticyclical policy of deficit spending. In principle it is clear that a system of autonomous national policies, like an oligopolistic market structure, does not lead to an optimum situation for the group. This optimum requires the general acceptance of a goal which is to the advantage of all concerned. In other circumstances, world policy might soundly be based on the interest of some dominant country; but in the present world it can only be based on the interest of all.

The need to break through narrow nationalist concepts has been increasingly felt for a long time. To illustrate the point we may remind the reader of American participation in two World Wars which initially did not affect the United States, and of the Marshall Plan. The process of broadening the horizons of Western policy-makers is a complicated and irregular one, but it has been gaining momentum and has recently affected economic affairs. To a considerable extent it is a natural development, even from the national standpoint, for with decreasing transportation costs and the increasing interdependence of national economies it is in the national interest to take a broader view. The contrast is less between national and international interests than between a narrower and a broader view of national interests. When national, or even regional, economies could be considered as isolated entities, one country's suffering did not affect the well-being of others. In an interdependent system, economic ills are generalized. Even more important is the possibility that economic distress in one major coun-

try might have an adverse effect on the political stability of the whole world. Violent actions by desperate people may easily lead to widespread conflicts.

In some measure the obligation of one country toward others was understood during the period of colonialism. Most ruling powers felt it their responsibility to fight famines and to enact certain basic laws in the interest of the colonial peoples. This sense of responsibility may be illustrated by the Netherlands Indies law prohibiting the sale of land by Indonesians to foreigners. There are other examples. Nevertheless, the sense of responsibility did not go very far, and it was too weak to prevent happenings which were against the interest of subject peoples.

Since World War II a new sense of responsibility has become apparent, as evidenced by the Colombo Plan and the Point Four Program. These are isolated examples; the most important example of a more systematic approach was, of course, the establishment of the United Nations and its specialized agencies. In the United Nations Charter broad tasks were formulated which may be regarded as an acceptance of world aims for economic policy. Thus according to Article 1, one of the purposes of the United Nations is "to achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character . . ." and "to be a center for harmonizing the actions of nations in the attainment of these common ends." Further, Article 55 states that "the United Nations shall promote a) higher standards of living, full employment and conditions of economic and social progress and development. . . ." Article 56 adds that "All members pledge themselves to take joint and separate action in cooperation with the Organization for the achievement of the purposes set forth in Article 55."

Granting that the United Nations Charter is important as the bearer of new responsibilities in the field of economic policy, we must immediately add that it represents only a beginning. The aims are so vague and general and are formulated in such nontechnical language that only a foundation has been laid, no building erected. If the charter is to be taken seriously, we must specify in technical

terms the aims of the organization. We must also indicate the instruments[2] and other means to be employed and to what extent they should be international or supranational in character. In other words, the whole complex of economic institutions and measures needed to achieve the general aims set forth in the charter should be designated by experts in the field to make its implications clear to the political community. So far, this natural follow-up to the work of the founders of the United Nations has been undertaken only in a very partial way.[3]

It is true that some important specialized agencies have been created; some of them even antedate the United Nations. We now have the International Monetary Fund, the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Special Fund, the Food and Agriculture Organization and some more specialized agencies in the noneconomic field. Also, the International Labor Organization (ILO), the oldest of the international institutions, has been given the status of a specialized agency. All these institutions are doing important work in their own fields. They all report to the Economic and Social Council of the United Nations, and this council meets twice a year. Much interesting information is being made available by these agencies and by the Secretariat of the United Nations. The latter also undertakes technical assistance operations and the Technical Assistance Board co-ordinates this work with similar work undertaken by the specialized agencies.

It cannot be said, however, that this loosely connected set of agencies is inspired by a well-defined policy, or that it represents the most efficient machinery for the execution of such a policy.

A policy, if it is to deserve the name, must be defined in terms of

2. Instruments are a class of means. They are of a quantitative nature and are used for the adaptation of the economy to small and frequent changes in certain data, e.g., tax rates, discount rates, reserve ratios, and foreign exchange rates. See J. Tinbergen, *Economy Policy: Principles and Design,* North-Holland Publishing Company, Amsterdam, 1956, p. 5.

3. Today some of us doubt whether the United Nations is still the most appropriate organ for an international economic policy. This question will be considered in section 6.4.

qualitative and quantitative aims, and in terms of certain means of carrying it out. It must also embody a decision as to what degree of decentralization is to prevail, that is, the division of labor between lower and higher echelons. Our present arrangements fall far short of this concept. For example, as early as 1951 a group of experts appointed by the Secretary-General expressed the opinion that the amount available for aid to underdeveloped countries was far below the amount necessary to reach reasonable goals. Today this is generally admitted and considerable action has been taken to relieve the situation. However, it is unfortunate that clear goals have never been established by any international agency. Nor has an attempt been made to determine what organs are needed in order to organize an international economic policy effectively. It is our contention that there is an urgent need to remedy these deficiencies, and that a committee should be established by the Economic and Social Council or by the General Assembly to investigate this subject. This committee should take the interests of the world at large as its frame of reference.

5.2 A ROLE FOR THE WEST: BUILDING AN INTERNATIONAL ECONOMIC ORDER

What role can the West play in constructing a new international community? Clearly the position of the Western nations has changed; no longer are they the masters of the world. Yet they may still play an important role if they have a real understanding of the new situation and of their own potentialities. Western leaders, first of all, must accept the fact that all peoples have a natural right to choose their own way of life. They must also concede equal political rights to all those who represent national interests. Within this framework we have to find the most appropriate contributions the West can make to the construction of a world economic order. These contributions must be made predominantly in those fields where the Western countries have special abilities and assets.

In economic terms, the significant factors are the "comparative advantages" – in the broadest sense – enjoyed by the Western

countries. During the last century there has been a clear shift in the sort of activities in which highly developed countries excel. Before the industrial revolution production everywhere was predominantly agricultural with some handicraft and there was not much international division of labor, except as determined by climate. With the industrial revolution manufactured products became the specialty of developed countries. As industrial activity spread, developed countries tended to concentrate on the production of capital goods. Today we observe that more and more developing countries are starting to produce capital goods while the most developed countries are tending to specialize in information services and research. The same trend can be observed within the developed group, where the leading country, the United States, devotes a relatively larger share of its resources to activities requiring specialized knowledge and experience, ordered in a scientific way, than the others do.

Apart from contributions to the knowledge of production processes, it seems that the Western advisers can contribute to shaping the economic policies of the less developed countries, domestically as well as in the international field. Here the possible contributions of the West are twofold. In the first place, the West has acquired a certain experience in international economic co-operation. It gained this experience from steps taken toward integration at various levels of economic operation in Europe and, to some extent, in Latin America. It has proved itself willing to give up elements of national sovereignty at a time when the young Asian and African countries are still too chary of their independence to enter into integration schemes. Remarkably enough, the West is more willing to undertake economic integration than the Communist countries seem to be. The situation is changing, however, and the comparative advantage of Western countries in this respect may not last long. On the other hand, Western experts have developed a high degree of objectivity, and they try not to prejudge any particular doctrine. Undoubtedly it is the spirit of Western science which gives them this comparative advantage.

The second current comparative advantage of the West lies in its

wealth. Because of their relative affluence the Western countries are in a position to make a unique contribution to one of the most pressing problems of the underdeveloped world. The underdeveloped countries, we may recall, are caught within a vicious circle of low incomes and low savings. They must either resign themselves to their predicament or apply authoritarian political methods to the problem of capital formation. They could be saved from this painful choice if considerable additional investment funds and technical assistance were made available by the wealthier countries. The benefits flowing from such a contribution would be incomparably larger, humanly speaking, than the sacrifice involved in making it. This follows from the simple fact that an additional dollar's worth of goods means much more to a man with a low income than to a man with a high income.

5.3 APPLICATION OF OUR OWN PRINCIPLES TO THE WORLD AT LARGE

Once it has been agreed that a stronger and better international order should be built, and that the West should offer its advice and services to the world's political leaders, it is necessary to decide upon the leading principles of the new international order.

It is only natural that in giving advice the West will be guided by its own experience with economic and social institutions and policy. Western society has since its inception been guided by the principle of efficiency.[4] It was the claim of those who defended the capitalist free-enterprise system in its early stages that it was far more efficient than its predecessor, feudalism. Capitalism led, however, to appalling contrasts in well-being and as a result of these contrasts the labor movement came into existence and flourished. Labor was severely critical of the free-enterprise system. Socialist thought assumed significant proportions in Western Europe in the beginning of the twentieth century; it developed somewhat later

4. "Efficiency" is used in the sense of the Western business-like approach of doing the best job possible once the aim has been defined.

and less vigorously in the United States. This influence led to a gradual change in institutions and policies, and these changes were governed by another principle which may be called solidarity.[5] Many measures were introduced to help those unable to help themselves: children, widows, victims of accidents and illness, the old, and the unemployed. Social insurance in its manifold forms and progressive taxes were some of the new institutions which evolved. More recently education has been made more accessible to groups of the population previously unable to afford it, and greater responsibility has been assumed by public authorities for general economic development.

The public sector was enlarged to include an increasing number of activities which, because of their external effects and increasing returns, could not be operated by private entrepreneurs in the interest of society as a whole. Other industries showing these characteristics were regulated to ensure that their operation would conform to the general interest. So mixed systems came into existence which are a far cry from 19th century capitalist economies.

There is, at the present moment, a marked difference between our domestic and our international policies. Only a small part of the institutions and instruments just mentioned have been applied in the international field. For reasons of political tradition the movement toward true community has stopped at national frontiers. Political convention has vested responsibility for community action in the hands of national governments, and these are anxious to avoid commitments. Even Social Democrats, by origin internationalists, have largely ceased to take guidance from international political programs, since their representatives in national governments — burdened with heavy responsibilities, often relatively new to them — are afraid to tie their hands.

This is one of the forms in which the "fear of commitment" has shown itself, leaving a vacuum in international economic policy. This fear constitutes a grave danger to our future. Using an

5. "Solidarity" refers to a willingness to regard the interests of others as being of equal importance to one's own.

ominous formula of Marx, we may say that history will eliminate systems which are not technically able to solve their problems. We are neglecting the interests of the world as a whole and those interests are becoming inseparable from our own.

We can no longer afford to disregard these interests, lest the world end in disaster for everyone, including ourselves. It is high time to apply the principles of efficiency and solidarity to the formulation of a world economic and social policy.

5.4 BROADENING OUR TIME HORIZONS

In reconstructing our economic order and our economic policy we not only need broader spatial horizons; we also need broader temporal horizons.

We are often guilty of shortsightedness with the result that Western policy, especially in international matters, tends to "run behind the facts" and lose initiative. It should not be overlooked that economic processes as well as processes of education and policy-making are time-consuming. Some of them extend over very long time periods. Decisions taken today will influence conditions for years to come. This is true of decisions on building and education, for instance; it is also true of decisions which, though they have technical consequences extending over shorter intervals, have a psychological aftermath. If our present decisions are to be correct they must take into account possible future developments. Often an awareness of the distant future exists only subconsciously, so that unrecognized sources of error are present in our calculations. But there has been a tendency recently to think more consciously about the future and to base business decisions on open forecasts instead of hidden assumptions. If this is good sense for business, it is also good sense for economic policy.

In technical language our last recommendation means that international economic policy must be based on forecasts and plans which are international in scope, and must be carried out by the appropriate United Nations organs.

Of course, projections or forecasts (which we consider synony-

mous[6]) can be based on varying assumptions about some of the data of the problem. These assumptions must be stated in order to avoid confusion. A very common assumption is that no change in policy will occur. For decision-making purposes this is a useful assumption. The forecast can then be compared with what we will call a "plan." This is another forecast, based on the assumption that the best policy feasible is followed. The word plan does not imply a policy of imposing a certain behavior pattern on private business. The best policy will have to be defined in terms of admissible aims and means.

5.5 BROADENING OUR OPINIONS ON SYSTEMS

The policies to be devised must be based not only on a wide range of interests and a long-run view of the future but also on a broad view of the relative merits of various socio-economic systems of which we have knowledge.

There is a tendency in popular propaganda to speak about the economic and social regimes of the Western countries and the Communist countries as if they were in sharp contrast to each other. The dichotomy is emphasized by labels such as "free" and "authoritarian" and "capitalist" and "socialist." There is a danger that top-ranking politicians and diplomats who do not have expert economic knowledge will also think in these black-and-white terms, which are not in conformity with the facts.[7] In other words, there is a danger of doctrinaire thinking which may do great harm to the world. We should be aware of the existence of a whole range of

6. It may be worth while to clarify a few concepts about which some confusion exists. Some technicians in this field distinguish between forecasts and projections. If we exclude operations which are designedly below the standard of scientific work, we may define projections as estimates of future levels of relevant variables; it goes without saying that these estimates can only be based on our knowledge of the forces operating. Unexpected forces are by definition not taken into account. A distinction between projections and forecasts, which do contain random elements, does not seem to serve any particular purpose if forecasts are supposed to be "exact" estimates of the future. Because of unforeseen forces, such exact estimates are not possible.

7. See Gunnar Myrdal, *Beyond the Welfare State — Economic Planning in the Welfare States and Its International Implications,* Duckworth, London, 1960.

possible systems using institutions and instruments of varying character; our aim must be to find the best system without reference to preconceived ideas. To choose, on doctrinaire grounds, a system which is not optimal would be stupid.

The problem can, of course, be more easily posed than solved. Our knowledge is only partial and must be augmented by intuitive beliefs, a condition which necessarily introduces differences of opinion. But at least it is now certain that the best system cannot be found at the extremes of the scale. Free enterprise in its older, 19th century form is not the best system; neither is complete regulation of all details. It is mainly a question of degree. Some activities are best carried out by public means while others can best be handled by private means. It makes sense to leave many markets free and to regulate quite a few others. Taxes are necessary; even relatively high income taxes do little harm while making possible many benefits. Incomes cannot all be equal, but extreme inequality so spoils the team spirit in society that it is highly dangerous, aside from being contrary to humanitarian principles. Thus on almost all counts the golden mean seems to be what we seek.

Much more analytical and empirical work must be done to define the optimum for economies in differing circumstances. This is just as much a work of careful engineering as is any industrial process, except that the subject matter is more flexible, and sometimes more evasive; seldom will heroic simplifications be of much help. The optimum is characterized by more interference in times of war or other emergency than in times of prosperity. Developing countries are in a desperate state of poverty and their optimum is not identical to ours. As countries, Communist and non-Communist, become more prosperous and mature, their optima will change.

Summarizing the points made in this chapter, we indicated that future socio-economic policies should be based on the interests of the world at large, which must be stated in terms of certain well-defined aims. These aims and the most important means to be used should be specified by the United Nations. Suggestions on the pos-

sible choice will be made in section 6.2. The means consist of a number of institutions and instruments, at various levels: international, national and local. The degree of centralization and the type of political instruments to be used should be pragmatically determined, so as best to serve the interests at stake. Because of special experience in related fields, Western experts may play a useful role in advising policy-makers on the optimum regime. Efficiency and solidarity should form the cornerstones of international policy. Some of the instruments which Western countries have employed in order to remedy the deficiencies of the free-enterprise system may be extended to the international community. Income transfers, for example, might help developing countries to break out of the vicious circles which bind them. Future policies should also be based on long-range forecasts and plans.

CHAPTER 6

THE JOB AND THE TOOLS

6.1 THE SETTING OF GOALS

We will assume in the following discussion that the principles set out in Chapter 5 are to act as a guide for Western politicians anxious to give a new shape to the world economy. In this chapter we will specify more concretely the contents of an economic policy for the world at large and the machinery necessary for attaining the goals of such a policy. In so doing we will make a number of suggestions designed to elaborate a policy for the United Nations, the need for which was expressed in section 5.1.

First, the United Nations should be explicit about the goals that are to be pursued in international economic policy. Economic policy-making is a job just as any other, and a job cannot be done efficiently if no clear goal exists. Efficiency is a relative concept; it can

only be measured by making regular checks on the progress made toward set goals. No large business enterprise would have any doubts on this score, and politicians can no longer be an exception to the rule. It is true that public policy-making involves risks, but the same is true of business policy-making. Moreover, there are also advantages in having goals clearly in mind in that it paves the way for a public announcement of intent. It has become increasingly apparent that there is an announcement effect in matters of economic policy. In our frame of reference we contend that it is a favorable effect. Developing countries are likely to be impressed by an advance announcement of a well-conceived development policy.

The setting of goals for an international policy is possible because there is considerable parallelism in the goals countries set for themselves. With some degree of central economic planning going on in most countries nowadays, under a variety of names, goals at the national level are more clearly formulated. Usually national policy-making focuses on production in general, employment, the balance of payments, prices, and, in some cases, the distribution of income among social groups or regions. It is true that the emphasis given to the individual goals differs; developed countries emphasize employment, the balance of payments, and distribution, whereas developing countries stress productivity and sometimes prices. There are also differences of emphasis among the developed countries and differences in the levels and rates projected. Thus the goals set for production (or income) increases by some developing countries, e.g., the United Arab Republic, Japan, or Turkey, may be as high as 7 or 8 per cent per annum. They are more modest for developed countries; for example, the OEEC countries as a group aimed at 5 per cent for 1955–1960. This same increase was projected by India in her last three plans, because internal saving and expected external aid would not permit a higher figure. The formulation of goals for the world at large might bring these figures into a more reasonable alignment.

Even though there is considerable uniformity in thinking about the objectives of economic policy, the formulation of goals for the international community will be a major job. To go into great de-

tail would be impossible and unwise. The best procedure is to try to arrive at a courageous but realistic set of central aims.

These central aims must include development targets for national income over a period of five years, not necessarily for all countries, but for the larger ones and for groups of the smaller ones.

These income targets imply employment targets; for developed countries they may mean the avoidance of cyclical unemployment and the rapid elimination of structural unemployment. For developing countries they may mean the elimination, after a certain period, of structural unemployment.

Balances of payments are a second element of the aims; by and large the target must be the equilibrium of all balances. A third element is price stability, which may be defined in terms of maximum deviations to be tolerated for a number of main trade products, much as in the case of the Wheat Agreement. For the industrial countries targets may also be set with regard to the general price level; perhaps this would provide an example for the main developing countries. Finally, income distribution targets can be set or, alternatively, this can be left to the national economies. As far as the international distribution of income is concerned, some change will be implied in the national income targets. Basically these figures should indicate a convergence rather than a divergence of real incomes per head.

We stress the word convergence because we do not think that a rise in incomes of underdeveloped countries beyond the subsistence minimum would suffice to make the world stabler. It is true that the worst thing to be removed is incomes below the level of subsistence; but the concept of subsistence level is a relative one. As productivity grows so does the conception of what is necessary in life. What makes people unhappy is large differences in income; poverty is more easily borne if everybody is poor than if differences are large. What irritates people is that the same kind of work is paid so much better in one country than in another, and the smaller the world becomes, the more important will these comparisons become. It will be wise policy to understand this in advance.

6.2 SOLIDARITY IN INTERNATIONAL POLICIES

In this section we will elaborate on the means whereby an international economic policy can be implemented. The choice of means must be based on the general principles of solidarity and efficiency, attributes in which nations are seriously lacking today.

The separate nations will have to show a sense of common responsibility for the definition of international aims and the implementation of world policies. Solidarity has to express itself in the introduction, on the international level, of the sort of agreement which exists among the various political units of a large decentralized country. Although state or provincial governments are not always fully co-operative, they at least have an understanding of the corrective role of the central government. Similarly, national governments and their citizens must accept co-responsibility for the correct execution of a program for the world at large. This sense of responsibility must reveal itself in the means chosen for a common development policy. As an illustration of the proper attitude, an American senator in judging an aid program proposed by his government should not ask whether it is in the interest of the United States, but whether it is an example of how a country should behave if we want to make this world a proper environment for a thoughtful and broadminded international regime.

What is needed in concrete terms is a system of capital flows — in the form of grants, loans, and participations — sufficient to attain the goals of a converging development of incomes and equilibrated balances of payments. More particularly, a sense of common responsibility requires that the various countries contribute according to their "ability to pay." Professor Rosenstein-Rodan, in a study for the Center for International Studies of Massachusetts Institute of Technology,[1] has proposed that relative contributions be based on a fictitious income tax applied equally to all countries. His proposal is the best basis for discussing this important instrument of economic policy.

1. "International Aid for Underdeveloped Countries," *Review of Economics and Statistics,* May 1961, pp. 107 ff.

It is a question of semantics whether grants should be called capital transfers or not. Probably the simplest way of looking at grants is to regard them as current contributions to an international development budget. They are analogous to current budget items for development purposes inside a country in that the location of the projects bears no necessary relation to the geographic source of the funds expended. Current transfers are a normal phenomenon within each nation as the result of social and educational policies backed by the theoretical teachings of welfare economics. Even though welfare economists are not yet able to indicate the optimum level of income transfers, and even though the particular type of transfer implied in income taxes does not conform with the conditions for a welfare optimum, income taxes can be shown to contribute to social welfare.[2] If solidarity is to become a reality not only within the frontiers of each country but in the world at large, current transfers, organized under a current international budget, will have to be accepted as a natural phenomenon too. The existing United Nations budget is one example in existence; for many reasons we should wish it to grow considerably. There may be a need for a current budget for IDA or OECD as well.

A common development policy will require not only a larger international investment scheme than has hitherto existed but also an international education scheme. In part this is a question of money, and so falls under the preceding subject, but in education the financial question is relatively less important than it is for material needs in general. An education program will call for considerable efforts in manpower, since in the initial period teachers will not be available in sufficient number in the developing countries. International solidarity here translates itself into a sizable program of technical assistance in its many different forms. Difficulties are created, however, by language barriers. Except for the relatively modest number of foreigners who have learned the language of the trainees, the possibilities for active outside participation are limited to those pro-

2. See J. Tinbergen, "Should the Income Tax be Among the Means of Economic Policy?," in *Til Frederik Zeuthen,* Nationaløkonomisk Forening, Copenhagen, 1958, p. 351.

grams of advanced training which can be conducted in international languages. The situation can be improved, of course, by teaching more languages at Western universities.

Solidarity also can and must play an important part in the implementation of stabilization policies. The achievement of price stability requires the institution of more commodity agreements and of an international insurance scheme against heavy declines in export receipts. Governments of the developed countries can show their community feeling by entering into such schemes with fewer reservations than in the past.

Finally, trade policy is another area where a higher degree of solidarity can be displayed. Sizable reductions in trade impediments are necessary if we are to arrive at a situation more in conformity with world interests. The spirit which led to the European Economic Community and to the proposals for Latin American integration or for the integration of the Arab region must be extended to wider areas if we are to approach more closely to the world optimum.[3]

6.3 EFFICIENCY IN INTERNATIONAL ECONOMIC POLICY

Efficiency means the most favorable ratio between ends and means. As long as only one end is aimed at, say a given increase in production, the attainment of maximum efficiency depends upon finding the cheapest method of accomplishing that task. In single-purpose problems efficiency can be expressed in physical units, as we know from simple applications in industry. If multiple ends and multiple means are involved, there must be a common measure to enable us to compare the various ends and means. The final criterion will always be social utility, a familiar but difficult concept of welfare economics. In practical cases we can sometimes use

3. A convincing plea for fewer restrictions on imports from developing countries is made by ECE in its *Economic Survey of Europe, 1960,* Geneva, 1961, Ch. 5, p. 48, where it is argued that in the next twenty years developing countries must increase their exports to Western Europe by some $5 billion if their balance of payments is to be in equilibrium.

money as a common denominator. Often, however, "shadow" prices, i.e., prices equating demand and supply, must be used in place of actual prices if we are to acquire an insight into benefits and sacrifices.

Some knowledge has recently been gained as to the relative efficiency of the alternative instruments of economic policy available for short-term adjustments to changes in exogenous factors. In anticyclical policies meant to stabilize total demand, changes in public finance (public expenditure and taxes) are considered more efficient than changes in factor prices (interest and wage rates) because the former have a strong and clear influence on total demand while the influence of the latter is weak and uncertain. For the stabilization of prices, on the other hand, wage rates are an efficient instrument because of their direct influence on the price level. If it is desired to pursue two targets simultaneously, it will be necessary to use two instruments at the same time; the best combination consists of a fiscal policy measure and a wage rate change. To refrain from using the wage rate and to use instead two instruments of public finance or budgetary and credit policy would mean that in some cases very big changes in these instruments in opposite directions would be necessary, which would meet with many difficulties.[4]

Less precise knowledge is available with regard to long-term economic adjustments. Yet some insight has been gained concerning such matters as how to restore a fundamental disequilibrium in the balance of payments and how to further industrial development. In connection with balance of payments problems it is known that the adjustment of exchange rates is a more efficient policy than the adjustment of wages in that it requires less violent changes and less disturbance of social equilibrium.[5] To promote industrial development, that is, to increase the capacity of the economy to absorb more assistance in this field, public investment in the sphere of infrastructure and subsidies and technical assistance to stimulate

4. For a more detailed analysis of the highly technical problems involved, see J. Tinbergen, *Economic Policy: Principles and Design,* North-Holland Publishing Company, Amsterdam, 1956, Chapters 3 and 4.

5. See *ibid.,* p. 113.

private investment will in many circumstances be an optimal combination of means. If private initiative is weak, public investment in basic industries may be useful too.[6] Clues to the optimum regime, i.e., the most efficient set of institutions, can be obtained from welfare economics with the aid of econometric studies (see sections 2.5 and 5.5 for examples). Welfare economics is that branch of economics which tries to determine what conditions must be fulfilled by the economic institutions in order to permit the economy to attain the maximum of well-being consistent with the natural, psychological, and technical data. The term welfare economics is sometimes confused with the term welfare state, but the latter does not necessarily fulfill the conditions formulated by welfare economics. Even though there are many unsolved problems in the field of welfare economics, some generally accepted propositions have been formulated.

Some useful information, then, has been accumulated concerning the most efficient set of institutions and instruments which a single country can use to achieve a given set of aims. A further point to be decided is how to organize the use of these means in an international community. The core of this question is the appropriate degree of decentralization, or the division of labor between supranational, national, and lower-level authorities.

Here we come to a very important question. In order to arrive at an optimum organization from the world's point of view, we must disregard traditional preferences for narrow national autonomy and concentrate on the technical aspects of the international task to be performed. Again welfare economics can help us. We want to know which organization will result in the purest decision-making, and welfare economics provides us with criteria for making a choice.[7] Decisions will be closest to optimum when the benefits and costs involved are properly estimated by the policy-makers. It is the drawback of national administrations that they are responsible

6. See J. Tinbergen, *The Design of Development,* Johns Hopkins Press, Baltimore, 1958, pp. 63 ff.

7. See J. Tinbergen, *Centralization and Decentralization in Economic Policy,* North-Holland Publishing Company, Amsterdam, 1954.

both as to subject matter and as to the group of countries involved. It would be of great importance to have the United States participate in this co-ordination.

6.4 THE ROLE OF INTERNATIONAL AGENCIES

If the need for more centralization in the use of some vital instruments of economic policy is accepted in principle, questions arise of the utilization of existing agencies and the scope of the new agencies which may be needed. The major alternatives are the United Nations agencies and agencies covering smaller groups of countries, such as IBRD and, with the same membership, the International Finance Corporation (IFC) and the International Development Association (IDA), or OECD.

In making a choice some elements must be considered which go beyond the purely economic sphere. The main difference between the United Nations and the other groupings is, of course, the membership of Communist countries. Co-operation with Communist countries has sometimes been difficult if not impossible. Must we risk the failure of the policies advocated by trying to institute them in co-operation with Communist countries? There is one cogent reason why we should accept some risk. The world as a whole is in vital need of a way of peaceful coexistence. While the most urgent problem is that of security, an international order will have to bear on economic and social issues as well. These issues may be good issues on which to try out peaceful coexistence. Proposals for universal co-operation on matters such as trade and development can be considered as proposals for coexistence. For one thing, an elaboration of the meaning of coexistence is badly needed. Our suggestions regarding an international economic policy as given in the preceding sections may be considered as such an elaboration. We will add some extra-economic suggestions in Chapter 10. For the moment we wish only to say that it is worth while giving more tasks to the United Nations.

This does not mean that United Nations organs — that is, organs at the highest international level — should have complete control

of all the instruments of economic policy which need centralized handling. If it is agreed that capital and income transfers for developmental purposes are such an instrument, it does not necessarily follow that all these transfers should be made through the United Nations. Two minimum conditions must be fulfilled if the instrument is to be properly used: all transfers at lower levels must be recorded at the "center," and the center must be able to supplement these "lower-level" activities so as to make the total investment pattern optimal from the international standpoint. If existing "lower levels" such as IBRD, IDA, EEC, the Colombo Plan, the United States government, and so on, together with private investors, do not make sufficient means available to, say, Southeast Asia, supplementary means must be on hand to fill this "gap" so that the total pattern is acceptable. This may be possible with relatively modest means, the more so where the lower-level institutions are already aware of their world responsibilities. Considerable decentralization in the execution of policy may therefore go hand in hand with centralized supervision and supplementary action.

A major decision confronting the non-Communist countries concerns the organ which will have to disburse the considerably larger development funds to be advocated below (see section 7.1). For the time being the International Development Association (IDA) seems to be the most appropriate organ, since it is operated by the experienced staff of IBRD. Its policy will have to diverge from the Bank's at several points, however, and it may turn out that an independent organ would be better suited to the task.[9]

Another possibility is that OECD be given this responsibility. OECD has the advantage of experience in handling problems of international economic co-operation. On the other hand, it is exclusively a Western organization, and the inclusion of developing countries in the disbursing agency would seem to be a condition for a successful common development policy.

Many tasks in economic policy can be left to autonomous action at still lower levels. Most matters of public finance can and must be

9. See Andrew Shonfield, *The Attack on World Poverty,* Random House, New York, 1960, p. 156.

handled at national and sub-national levels. There is a long list of public activities which can best be carried out at the local, the provincial, or the state level.

There is scope for simplifying the organizational structure of international co-operation. The pattern of organization is almost chaotic, especially in Europe where co-operation is strongest. Efforts to unify the operation of the governments in EEC are highly desirable and are already under way. If the United Kingdom becomes a member of EEC, the Western European Union (WEU) may become superfluous. In principle, Benelux should also become superfluous. We must even hope that OECD may become a duplication of an Atlantic Union.

There is reason, however, to maintain and even to strengthen co-operation in other continents. For several activities it would seem useful to have bodies intermediate between the national governments and the United Nations. Here the agencies could be the existing United Nations regional commissions: the Economic Commission for Africa (ECA), the Economic Commission for Asia and the Far East (ECAFE), the Economic Commission for Europe (ECE), and the Economic Commission for Latin America (ECLA). Of course, it is conceivable that smaller groups of countries will form agencies to carry out such tasks, and that these groups will later merge. It is also possible that permanent groups with a membership different from that of the existing regional commissions will appear (see section 8.4).

The last question to be examined in this section concerns the need for specialized agencies. These already exist in several fields; examples include IMF, IBRD, IDA, IFC, FAO, GATT, ILO, and UNESCO. While there is no need at the moment to create a new specialized agency for industrialization, this idea may be worth further exploration.[10] The question whether the activities of the specialized agencies are already sufficiently co-ordinated may be recommended for exploration at the same time.

In conclusion we would like to stress the need for a strong

10. See Shonfield, *op. cit.*, pp. 237–239.

United Nations Secretariat, endowed with substantial funds and charged with some important tasks, including the making of forecasts (discussed in the next section) and the elaboration of targets for international economic policies in the fields of income transfers, development financing, and stabilization (see section 5.1). These tasks cannot be carried out and the co-operation of governments cannot be sufficiently enlisted if the Secretariat does not command considerably more financial means, particularly for supplementary action in the field of development, than in the past.

6.5 FORECASTS, PLANS, AND ANNUAL DISCUSSIONS

An efficient international economic regime not only requires aims and means and appropriate agencies to handle them; it also requires a planning apparatus, as any complex activity does, and it requires supervision. These needs should be carried out by the highest economic organ in the international hierarchy, which is the Economic and Social Council of the United Nations (ECOSOC). This council should be the place where world economic policies are fruitfully discussed, both in prospect and in retrospect. The traditional discussion of the world economic situation must be made more operational. This means that the *World Economic Survey* should bring out the main deviations between desirable and actual development and should be supplemented by a document containing international economic plans or programs. In comparable documents prepared by some countries (see section 5.4) one usually finds a forecast of probable developments without a change in policy, and a plan indicating the developments most desired. Here, too, world aims should be formulated (section 5.1).

The task may seem to many an impossible one. Will it be possible to arrive at any consensus among the main governments? Will not the debate become a propaganda show for Communist and non-Communist countries, or even just for Communist countries? Does it make sense to discuss government policies in a meeting without any competence to act in the field?

Much depends on the way the discussion sessions are developed

and on the manner in which competences in the international field are acquired. As a general rule, it probably would be wise to start on a modest scale. This means that in the first years of this experiment only a few extremely important areas would be discussed, namely the desirable levels of aid and development per continent, and anticyclical policy for the world at large. The establishment of an international development budget may give some direct operational sense to the debate. In addition, OEEC's tradition of examining member countries' policies may be introduced, if the atmosphere permits.

One of the important factors in the effectiveness of international discussions will be the position of the United Nations Secretariat. As was advocated in the preceding section, the Secretariat should become more independent; it should change from a "servant," as it has often considered itself, to an authority. In several fields it already acts as an authority because of the quality and experience of its staff. However, tasks must be assigned to it in the field of development policy.[11]

Some remarks may be added on the methods and procedures to be used in preparing the forecasts and plans. The methods might consist, to begin with, of the simple models proposed and elaborated by Professor J. J. Polak of IMF.[12] These models are an international version of some of the post-Keynesian econometric models. Many opportunities exist to make these models more precise, as witness the work done at national levels; but in the beginning simple approaches must be recommended. In order to use these models it is necessary to estimate the so-called extra-economic phenomena influencing the economic situation, and the so-called coefficients,

11. It may be mentioned here that the Second (Economic and Financial) Committee of the UN General Assembly adopted a draft resolution on November 16, 1961, requesting the Secretary-General among others to establish an Economic Projections and Programming Centre — with sub-centers as appropriate in the regional economic commissions — to intensify development planning activities already under way and to make long-term projections. (See *United Nations Review,* December 1961, pp. 29 ff.) This resolution was adopted by the General Assembly at the December 1961 meeting.

12. See J. J. Polak, *An International Economic System,* University of Chicago Press, Chicago, 1953, and numerous later publications in the IMF Staff Papers.

i.e., the intensities with which such influences (and mutual influences of economic phenomena) are acting. Among the extra-economic phenomena government expenditure and investment stand out; crops are very important for annual forecasts, but for longer-range forecasts their role is negligible. An increasing volume of international comparisons is available which may make it possible to estimate coefficients for countries not yet able to make such estimates for themselves.

The procedure would consist of the following steps:

(i) some central directives with regard to the assumptions to be made and the figures to be used are formulated and forwarded by the UN Secretariat to the Regional Commissions;

(ii) the Commissions forward this information to their member governments, asking them for the figures needed;

(iii) incoming figures are evaluated, and perhaps supplemented, by the Regional Commissions and forwarded to UN Headquarters for further evaluation;

(iv) the resulting set of forecasts for national income, imports, exports, investments, and consumption (public and private) are made available to all governments;

(v) UN Headquarters uses these figures to estimate the development of world demand in certain main sectors of production, with regional subdivisions.

Among the figures should be ones — to be estimated by Headquarters on the evidence received — on financial aid, subdivided according to supplying and receiving countries and including both a forecast and a set of goals.

A discussion of these figures might be an outlet for national tensions and irritations. As we have suggested, much will depend on the approach chosen for such a debate, and on the personality of the debaters.

CHAPTER 7

INVESTMENT CRITERIA ON A WORLD SCALE

7.1 INVESTMENT IN EQUIPMENT AND IN MEN

The main groups of means or instruments of international economic policy described in Chapter 6 will now be taken up one by one. Since investment policies are of primary importance they will be taken up first.

A number of the criteria for an effective investment policy are already known from national development policies. These criteria need to be formulated for use on a world-wide scale. They should help to solve a number of important problems related to the size of the program and its distribution over contributors and recipients, over branches of the economy, and over the public and private sectors. The distribution of individual projects will tend to be a domestic matter, but if large projects are at stake, some interna-

tional co-operation will be necessary, either because the project is situated in several adjacent countries (an example would be a river valley project) or because it is individually financed by an international agency or another country.

Investment must be understood, from the start, to mean investment in both material assets and men, since the two are complementary in production. Investment and planning in education have lagged behind investment in material assets in development projects, but the field of education is now receiving more adequate treatment. As was pointed out in section 6–2, the financial factor is not as great in education requirements as it is in material requirements — the requisite investment in the former may be only some 20 or 30 per cent of that in the latter — but the human factor is relatively greater, both as to trainees and trainers. A special problem is the length of the training period, particularly for higher skills.

The decisions on a world investment program should be taken in a number of successive steps. The first decision must concern the size of the program. It should be based on the aim of replacing the present pattern of diverging standards of living or real incomes per head with a pattern of convergence. We interpret this to mean that the percentage rate of increase must be made larger for developing countries than for developed countries. The order of magnitude of the necessary increases in investment can be estimated with the aid of some crude coefficients. Since incomes per head in developing countries are now rising by 1.5 per cent per annum, increases in production must be at least 2 per cent per annum higher than they now are, and preferably 4 per cent higher.

Estimates made by the Netherlands Economic Institute[1] show that in order to achieve a 2 per cent increase in production, some $7 or $8 billion additional investment annually will be needed as a minimum. In view of the low incomes in the developing countries, a large part of the necessary increase will have to be provided from international sources. The minimum increment indicated repre-

1. *The European Community and the Underdeveloped Countries,* Netherlands Economic Institute and Documentation Centre of the Action Committee for the United States of Europe, May 1959 (mimeographed).

sents about 1 per cent of the income of the developed countries. Since the amount they now contribute is estimated to be somewhat more than $7 billion, their contribution will have to be at least doubled. Later a further increase might be desirable. In the last few years the experts of the main developed countries have come to feel that contributions of the order indicated are necessary to underwrite a new approach to international co-operation. Public opinion has not followed this lead; considerable doubt has been expressed whether:

(i) the developed countries can bear the burden; and
(ii) the developing countries can absorb the new investments contemplated.

In appraising the issue, the fundamental importance of stimulating growth in today's underdeveloped areas should not be overlooked. Once we are aware of the dimensions of the annual increase in income in the developed countries, the concern about our ability to bear the burden cannot be taken too seriously. The present population of the developed countries experiences on the average an annual increase in income of about 2 per cent, or some $15 billion. The increase — always in comparison with the same base year — is $30 billion after two years, $45 billion after three years, and so on. It should be possible, then, to increase the capital flow to the developing countries by some $7 to $8 billion in the first few years, bringing it thus to a level of about $15 billion annually, and later to increase it by an additional smaller amount to a still higher level. It goes without saying that the problem of financing this aid would be considerably simplified if an arms reduction could be agreed upon.

As for the absorptive capacity of the developing countries, this is a problem in the short run only. This means that the most desirable features of the program can be achieved in only a few years of intensive effort. In view of the dangers involved in allowing the gap in well-being between the developed and the underdeveloped countries to widen, it is wrong to conclude from the fact that present absorptive capacity is limited that our task is not as large as originally indicated; instead we must step up that absorptive capacity by all available means.

Some of the activities which can contribute to increasing the absorptive capacity of underdeveloped countries have not been given sufficient attention.

Contracting firms that do a large part of their business in developing countries could give the local citizens more instruction and training, at different levels. The cost of these additional business activities could be financed by development aid. We could take advantage of the presence of specialized personnel by extending knowledge in these countries, and after the termination of the job the trained persons could make use of their acquired skills elsewhere.

Similar advantages could be derived by establishing enterprises in which local as well as foreign capital and personnel participate. Some developing countries promote these "joint ventures" by investment laws and the activities of development banks. However, more initiative could be taken by authorities of the developed countries. One possibility would be a joint effort by countries at all stages of development to establish an international insurance system for investments abroad (see p. 134). Joint ventures not only facilitate the transfer of technical and managerial skill; they are also a means of mobilizing more local capital.

An appropriate measure to step up absorptive capacity may be to grant licenses conferring industrial property rights.

The favorable impact of investment aid on the balance of payments of the receiving countries deserves more attention than has so far been given to it. Many institutions are now engaged in dealing with exchange controls and trade restrictions; they will find their problems largely solved if more aid is given for development. This is particularly true of the activities of the International Monetary Fund.

7.2 BALANCED INTERNATIONAL GROWTH—I: RESOURCES

Decisions must also be made regarding the composition of the program. Recently some writers have advocated an "unbalanced"

process of development rather than a balanced one.[2] Arguments advanced are that:

(i) some strategic industries may be pushed so as to automatically induce other activities; and

(ii) some industries or countries have a higher absorptive capacity than others and may therefore be used as levers.

Admittedly there are such industries and such countries; their existence is among the data of the problem. And it is proper to use the "handles" or instruments which are most effective in reaching the goals of development policy. But what we seek to attain is a balanced situation, not one of disequilibrium. Unbalance, almost by definition, is a pejorative term. Of course there is a question here of choice of words; "balance" should not mean a static condition, but a dynamic one.

The program must be balanced, first of all, with regard to contributions. As set out in section 6.2, the best basis for discussion of an equitable assessment is the proposal of Professor Rosenstein-Rodan.[3] In principle, contributions should be made by all countries, developed and less developed, as an expression of the fact

2. See Albert O. Hirschman, *The Strategy of Economic Development,* Yale University Press, New Haven, 1958, and Andrew Shonfield, *The Attack on World Poverty,* Random House, New York, 1960, p. 6.

3. See "International Aid for Underdeveloped Countries," *Review of Economics and Statistics,* May 1961, pp. 107–138. Rosenstein-Rodan proposes that the developed countries contribute to a program of capital assistance according to a progressive tax schedule applied to their income per family (of standardized size). He also suggests that it might be appropriate to base such a system of contributions on a country's real family income (corrected for price differences with, say, the United States) instead of on its nominal family income. Applying the United States income tax progression to the incomes per family, and multiplying the results by the number of families, he finds that the burden of capital assistance should be shared by the donor countries in the following way:

Contribution as Per Cent of Total Capital Assistance Program

	Based on "Nominal" Income	*Based on Real Income*
United States	71.3	58.6
Canada	4.1	3.4
United Kingdom	5.8	7.7
France	4.0	4.8
Germany (Fed. Rep.)	4.1	7.0
Other Western Europe	4.3	7.8
Oceania	1.1	1.7
USSR	5.3	9.0

that the program is a common effort; and, following the example of IBRD, no distinction should be made between receiving and contributing countries.[4] In Rosenstein-Rodan's proposal this principle is not fully applied: only the developed countries — in his example countries with an income per head above $600 — would contribute. A further refinement of his approach, and one worth further exploration, is to make a country's contribution dependent upon its internal distribution of income as well as its average income.

The question may be raised whether the contribution should also be dependent upon the balance of payments position of the participating countries. Generally speaking this is not a logical notion, although there may be "hardship" cases which must be accepted as exceptions. What matters is a country's real income. Balance of payments difficulties can only be overcome by adapting national expenditures to national income plus income transfers. Developed countries can always contrive to cut expenditures, while an expanded program of international assistance will automatically improve the balance of payments of underdeveloped countries.

The contributions may be made in different forms and in the framework of different schemes, as set out in sections 6.3 and 6.4. There must be one center where records are kept and where the supplementary contributions necessary to bring the total program and the contributions by each country to the appropriate level are paid in. The data collected by this center — preferably the United Nations Secretariat — should be the basis of the annual discussion in ECOSOC.

The contributions can take the form of loans or grants. Market loans, loans on easier terms (low interest rate, long amortization period, repayment in local currency), and medium-term credits are now used in various combinations.[5] Naturally, the type of contribu-

4. This applies more particularly to technical assistance programs, where less developed countries can often be better helped by developing than by developed countries.

5. In the period 1956–1959 the proportion of total public help given in the form of credits and loans was roughly 20 per cent for France, 40 per cent for the United States, 45 per cent for the United Kingdom, and 70 per cent for the German Federal Republic. (Calculated from OEEC, *The Flow of Financial Resources to Countries in Course of Economic Development 1956–1959,* Paris, 1961, Tables 2, 3, and 4.)

tion must be geared to the character of the project financed and to economic conditions, present and future, in the country seeking assistance.

Particular forms of restricted contributions are gifts in kind and tied loans. Contributions in kind such as supplies of surplus commodities are useful, since any development program will generate a need for increased food supplies for the workers previously unemployed. However, care must be taken not to disrupt markets in the receiving countries. Tied loans, or loans designated for specified countries, are less desirable, since they may force the receiving country to pay higher prices than necessary. But obviously if the choice is between a tied loan and no loan, there is some advantage in accepting the tied loan.

Several attitudes are possible vis-à-vis the inclusion of private investment. Since what matters to the developing countries is the total capital flow, it seems proper to include private investment in the statistics showing the total size of the program and the distribution between contributing countries; and this is the point of view adhered to in this study. It seems useful to seek the co-operation of private firms for the development of the "superstructure" — a topic which will be discussed in section 7.6.

7.3 BALANCED INTERNATIONAL GROWTH — II: USES

There must also be balanced growth if we compare the countries benefiting from the program. So far this aspect of development policy has been neglected, as is illustrated by the figures in Table 7–1 showing the aid received by different countries per head of population.

An attempt to devise a more systematic distribution of the available international funds has been made by Professor Rosenstein-Rodan and his staff at MIT using absorptive capacity as one of the main criteria. Rosenstein-Rodan's work would seem to provide a good starting point for programs in the immediate future. His figures center around an annual increase of 2 per cent in income per head. Countries with a relatively large absorptive capacity are sup-

Table 7–1

PUBLIC ECONOMIC ASSISTANCE RECEIVED BY VARIOUS COUNTRIES IN DOLLARS PER HEAD OF POPULATION, 1953–1958

Country	1953–54 to 1955–56	1957–58 to 1958–59
Countries with Per Capita Income Below $100		
Jordan	$ 9.40	$36.30
Korea	13.32	14.13
Bolivia	4.85	8.52
Indonesia	0.14	1.24
India	0.24	0.74
Countries with Per Capita Income Between $100 and $200		
Libya	17.00	31.64
Taiwan (Formosa)	9.62	9.14
Brazil	1.58	1.05
Ghana	0.46	0.48
UAR (Egypt)	0.80	0.41
Countries with Per Capita Income above $200		
Israel	25.00	24.61
Costa Rica	3.60	11.20
Mexico	0.86	2.04
Cuba	0.27	1.20

Source: United Nations, *Statistical Yearbook,* recent years.

posed to grow on a per capita basis by around 2.5 per cent, while countries with a relatively small absorptive capacity are expected to grow at rates ranging from 0.6 to 1.9 per cent, and some are even given negative figures.

These projected rates can only be of temporary significance since the absorptive capacity of a number of countries can be increased. One must also ask what effect these growth rates would have on the pattern of real incomes. It is unlikely that Rosenstein-Rodan's distribution would lead to a reduction of the gap between per capita incomes in developed and developing countries.

We are not convinced that an attempt should be made to concentrate aid on a few countries having an exceptional development potential;[6] the political implications of such a move would in our opinion be unfortunate.

There are other relevant criteria in addition to those already mentioned — desirable growth of income and absorptive capacity. As will be made clear later, there is some point in giving additional investment aid to countries willing to give up some of the trade preferences they at present enjoy in the framework of the European Economic Community.

Countries soliciting aid should have detailed development plans since these would facilitate an appraisal of their absorptive capacity. Many countries have already worked out such plans, and the habit is rapidly spreading. In some cases, such as Turkey, a development plan has been considered a condition for foreign assistance. This seems a useful approach. A development plan may be and should be an aid also in designing efficient investment policies, including policies governing the use of the country's own savings. A plan, if it is to be of any use, must indicate not only the rate of growth of national product envisaged but also the rates of growth in the main sectors of the economy and the most important individual projects to be carried out. For large countries, estimates of the regional distribution of growth and investment are also desirable. Forecasting and planning techniques are developing rapidly[7] and a considerable volume of technical assistance is being given in this field.

The use of so-called shadow prices, defined as prices which would equate supply and demand, is an important technique in the appraisal of individual projects. For various reasons, the prices paid for goods and services (including labor and capital) in developing

6. See W. Krause, *Economic Development,* Wadsworth Publishing Co., San Francisco, 1961, p. 503.

7. A long list of publications bears witness to the excellent work done by ECLA in this field. Recently ECAFE has made useful contributions, among which may be mentioned a summary of techniques in *Programming Techniques for Economic Development,* Bangkok, 1960 (Sales No. 60. II.F.3). A standard work is H. B. Chenery and P. G. Clark, *Interindustry Economics,* Wiley, New York, 1959.

countries are often not an accurate measure of the intrinsic value of these commodities. The main reasons for this are to be found in some fundamental disequilibria characteristic of these countries,[8] such as the following: a disproportion between the amount of labor and capital available, which often leaves a considerable part of the labor force without a necessary minimum of capital; a compartmentalization of the capital market, which leads to subnormal interest rates in the favored compartments; commonly, a fundamental disequilibrium in the balance of payments; and the protection of industrial markets in the initial stage of development. Under these conditions the intrinsic value of a project may be better estimated with the aid of shadow prices than with market prices.

Another factor which must be considered in appraising individual projects is the possible need for complementary investments. Investments in "international industries," i.e., industries producing goods which can be imported or exported, can only contribute to the balanced growth of a country if capacity is correspondingly increased in "national industries," i.e., industries producing items which cannot be moved over the frontiers, such as inland transportation, energy, and residential building. By a particular use of input-output tables, these complementary investments can be estimated.[9]

As we stated in section 6.5, an efficient international economic policy requires planning activity "at the top." The task, therefore, is to co-ordinate the planning activities of the international community, and to check the consistency of the national plans. This is largely a problem of organization, and as such it has two aspects of sufficient practical and political importance to mention.

One question is whether an organization comprising about 100 planning countries with one control center can be effective. Most organization experts would agree that there is room here for an "intermediate level," i.e., a grouping of the countries so that the center deals only with continental (officially, "regional") organizations,

8. For a general treatment of the problem see A. Qayum, *Theory and Policy of Accounting Prices,* North-Holland Publishing Company, Amsterdam, 1960.

9. See J. Tinbergen and H. C. Bos, *Mathematical Models of Economic Growth,* McGraw-Hill, New York, 1962, section 5.2.

while the latter maintain contact with the individual countries.[10] This implies, then, the need for continental organizations, perhaps with the continents split up into a few very big countries and groups of smaller nations. The regional commissions of the United Nations in Latin America, in Asia and the Far East, and in Europe would certainly be able to assume such a task, and it is to be hoped that the Economic Commission for Africa will soon develop the capability. A country like the United States could be in direct contact with the center, and one wonders whether in Western Europe an organization such as OECD might not be of help (see, however, section 8.4).

Another question concerns the checking of national or regional plans with the aid of a cross-tabulation of plans according to countries and production sectors. Certainly, a condition for balanced world growth is a harmonious distribution of investment over the main production sectors, that is, a distribution corresponding to the distribution of the demand arising from increased incomes. For reasons of information and democracy, organized producers (including employers' associations as well as employees' unions) should advise on the expansion of their trades.[11] This idea has been applied in France with considerable success. Obviously, producers must be organized on a world scale – or something comparable – and must have arrived at a common opinion as to the most desirable development of their industry before such a contact can be made.

7.4 THE OPTIMUM PATTERN OF DIVISION OF LABOR

Planning on an international scale will make it possible to consider more explicitly than any single nation can consider the problem of the best international division of labor. The various products demanded by the world should in fact originate wherever they

10. Similar reasoning must have led the Soviet Union to follow the creation of about 100 *sovnarkhozy* – the geographic planning units – with the creation of 17 larger units.

11. This idea will be elaborated in a forthcoming volume on planning which is to be a joint publication of Yale University and the Netherlands Economic Institute.

can be produced most cheaply. The main factors at stake are those summed up by the theory of international trade, namely comparative advantages in production and transportation. The mechanism of free competition does help to bring about an optimum pattern for some types of products. Yet free competition is hindered in so many ways that some checking is desirable. Such checking may be attempted with the aid of estimates of the costs of producing a large number of items at a large number of different locations. Proposals have been made[12] to make available to planners — national and international — the vast amount of material scattered over government agencies, offices of consulting engineers, scientific institutions, and perhaps even private enterprises. What might be done first is to estimate the cost of making the material comparable and publishing it: possibly the cost would be prohibitive.

Planning the best division of labor between countries is a relatively simple problem for activities where the optimum-size enterprise is relatively small. Small enterprises can be apportioned in an almost continuous way, as is usually suggested by economic theory. One additional unit will not influence prices very much and the criterion for establishing an additional unit is that the unit cost of the marginal enterprise will not be higher than the world market price. Evidently, we must define cost as the figure to be expected after a learning period, calculated by using shadow prices. If trade policy and subsidies are optimal, the pattern emerging under free enterprise would not differ very much from such a planned optimal pattern of production. This is not true for activities subject to considerable economies of scale or long gestation periods. The development pattern of free enterprise has a tendency to show, in the first case, an overemphasis on diminutive units, leading to excessive costs; and, in the second case, an alternation between too much and too little total production. National governments should not be free to plan such development without consulting with neighboring governments. Good advice can be obtained from comprehensive studies by the continental planning agencies. These agencies

12. In the Advisory Committee on the Work Program on Industrialization of the United Nations and in the ECAFE publication *Programming Techniques for Economic Development,* Bangkok, 1960.

devote considerable attention to determining the appropriate location and size of the units needed for an optimal market supply. As a rule there will be alternative solutions to the problem. A guiding principle should be to distribute the big units evenly among the countries of the continent so that all of them have a chance to reap the benefits of large-scale industry.[13]

7.5 TRAINING OF QUALIFIED PERSONNEL

As already observed, development rests on two complementary types of investment: investment in equipment and investment in qualified manpower. Today this fact is generally understood, and a modern economic development policy implies a policy of training at all levels. The training process is a lengthy one. A university-trained technician goes through some eighteen years of learning before entering the phase of practical experience — which, for that matter, must be considered part of his training, and not the least important part. In a period when the West's need for trained personnel for internal purposes — especially for further research — is increasing, we are confronted by the added demand for technical assistance to developing countries. In view of the numerous kinds of trained manpower at different levels of responsibility, the process of training requires co-ordination as much as the process of production does. A further complication is created by the fact that increasing the number of trainees necessitates increasing the number of instructors, who themselves must first be trained to teach their specialty. We must make every effort to use simplified procedures wherever possible, and to help the developing countries by temporarily offering them foreign teachers within the limitations of language difficulties referred to in section 6.2.

A distinction can be made between general education and specialized education and training. Specialized education is in many fields more closely connected with economic development, and

13. See W. Isard, E. W. Schooler, and T. Vietorisz, *Industrial Complex Analysis and Regional Development: A Case Study of Refinery-Petrochemical-Synthetic-Fiber Complexes in Puerto Rico,* The Technology Press of the Massachusetts Institute of Technology and John Wiley and Sons, New York, 1959.

complements it most clearly. General education, no doubt, is of significance for economic development, but it is also desirable for its own sake. A similar distinction can be drawn between medical care, strictly speaking, and health education. Distribution of the available resources over these and other fields must take into account not only the costs and the material results to be obtained but also the period of "production" and social satisfaction to be derived.

A major problem of technical assistance in this area is the training site. At the higher levels of training — the specialized intellectual levels — it would be natural for the trainees to move to the training agencies, which would be mostly, though not entirely, Western universities and production units. Some alienation from home conditions might occur, but this danger is more serious at the lower levels of training. Then, too, at the lower levels the number of people to be trained is so large that it would not be economical to move the trainees to the trainers. A shift in the opposite direction is needed here. There is, however, a growing tendency to send trainees at different levels to countries not too far away. This has the advantage that living and working conditions are more similar to home conditions than they would be in the West. In this context, regional training institutes designed to serve groups of countries are important. Western teachers can make valuable contributions as part of the international staff of these institutes.

Training should not be restricted to official education or schooling; to a considerable extent it must also include training on the job. Clearly, business firms — or, more broadly, production units including, of course, public enterprises — can make important contributions in this respect.

7.6 THE ROLES OF THE PUBLIC AND PRIVATE SECTORS

Finally, growth must be balanced with regard to public and private activity. As we have stressed earlier (in section 5.5), the dividing line between the two should not be drawn in a dogmatic way.

The balance between the two sectors should be determined by circumstances with efficiency as the main criterion. Efficiency must be measured in social terms; thus it is necessary to compare benefits to the nation as a whole with the sacrifices required. Those who want to do everything by private initiative or want to eliminate private activity altogether are guilty of a doctrinaire approach to the problem.

There is some consensus about the need for public activity in the infrastructure (see section 6.3). The main reason for this is that many of the projects involved do not yield an income to the investor, because for technical or social reasons no price can be charged for the product (e.g., roads and education). In addition, the large capital sum often needed is not always available in the private sector.

The superstructure — comprising manufacturing, agricultural, and mining activities — may be efficiently built up by private enterprise, if the local business community is sufficiently enterprising or if there is some interest from abroad. Many countries now try to encourage outside interest by laws or regulations guaranteeing fair treatment to foreign investors, and sometimes joint ventures with local investors are specially privileged. But if private capital is not forthcoming, recourse must be had to public industrial activity. Today's public enterprises do not differ much from private enterprises as to management and efficiency, but — if necessary — modern business forms can be introduced with assistance from abroad.

Mixed enterprises are another possibility. To take but one example, co-operative ownership of agricultural processing plants by farmers has been a successful expedient in several countries. Finally, private activity may be stimulated by subventions and technical aid, especially to small units. These smaller manufacturing units may be concentrated in industrial estates, where various elements of the infrastructure and technical assistance are available simultaneously.[14]

Subventions should place a premium on the use of labor rather

14. See J. Tinbergen, *The Design of Development,* Johns Hopkins Press, Baltimore, 1958, Chapter 4.

than on the use of capital; any worthy new project should emphasize the abundant rather than the scarce factor of production. Of course, the system of subventions has to be adapted to circumstances. In sparsely populated underdeveloped countries the use of the labor factor should not be encouraged. Furthermore, natural conditions and technical factors have to be taken into account; sometimes there is little choice as to the production methods to be used. As much as possible the administration of subventions should be linked to existing tax or social insurance schemes in order to facilitate supervision and keep costs down.

If waste is to be avoided, some interference by government seems necessary in all cases; big private units should be created only with the permission of the administration so that a check can be made to see whether they fit into the general plan. It goes without saying that if private enterprise develops in a way which complies with the criteria for efficient investment, it should be accepted even though it was not foreseen in the plan.

Private foreign investment — in which joint investment with local capital is of growing importance — will be facilitated if some of the noneconomic risks can be insured. Schemes already exist in the United States, Western Germany, and Japan to insure the risks of exchange difficulties (delays in payments and, in the German system, devaluation), nationalization without satisfactory indemnification, and war damage. Risks can be insured if they arise from investments in countries that have concluded agreements with these states in which stipulations are made for the treatment of capital;[15] such agreements are not required in the Japanese system.

Although these national schemes have undoubtedly encouraged the flow of private capital to the developing countries, a multilateral insurance scheme would seem preferable. Such a scheme would place a common responsibility on all countries concerned, capital-importing as well as capital-exporting. Developing coun-

15. In the German system insurance of an investment is possible even when an agreement with the country concerned has not yet been concluded, if that country has taken satisfactory measures to protect foreign capital. (See documents on "Gesellschaft zur Förderung des Schutzes von Auslandsinvestitionen e.V.")

tries thus could influence the setup and the implementation of the system and they could, together with the developed countries, share the burden of some form of guarantees. Capital-exporting countries could share the risks with many others, and so it may be expected that a large number of them would join such a scheme. The result might be a considerable expansion of the international flow of private capital.

Several proposals of this kind have been made recently. Of these we would like to call attention to the plan for a "Mutual Investment Insurance Corporation," which is designed to be an affiliate of IBRD. Recently this plan, together with some others, has been the object of study by the Bank.[16]

16. The idea for such a corporation was first discussed in a meeting of the CAFEA group of the International Chamber of Commerce in Karachi, December 1960. See the discussion paper by E. H. van Eeghen, *Memorandum on an International Guarantee Institution Covering Political and Calamity Risks of Private Capital in Development Countries.*

CHAPTER 8

MYOPIA AND FARSIGHTEDNESS IN TRADE POLICY

8.1 THE CASE FOR LESS CHAOS

The second group of means and instruments of economic policy to be considered is trade policies. More perhaps than other issues of economic policy, changes in trade policies are a matter for detailed negotiations. The results of such negotiations depend on a formidable quantity of technical minutiae which change almost from day to day. This study cannot hope to formulate proposals for direct negotiation; it can, however, help in analyzing the problems and suggesting a few main lines of action. This is of some value even for practical decisions because of the unparalleled complexity of the subject. The number of political leaders with a thorough knowledge of trade policies is more restricted than the number in-

formed about other economic policy issues. Much is left to technical experts in numerous specialized fields and to the innumerable pressure groups operating in this field.

The subject is complicated by the large number of goods and countries involved and by the fact that trade always involves pairs of countries. In addition there is the time element: changes in policy must be properly timed. A minor complication is the number of instruments applied: duties, quantitative restrictions, combinations like tariff quotas, and in some countries exchange rates which differ for different commodities. Viewed in toto, trade policy is a monster with a multitude of dimensions or degrees of freedom; an exact description of its state would require thousands of figures at the least. Trade policy is in chaos. That it has become so is partly the inevitable result of its multidimensional quality — a characteristic it shares with, say, detailed planning in Communist countries or in wartime economies — and partly the fault of governments that have left too many decisions to pressure groups.

This situation is undesirable if for no other reason than that it enables pressure groups to operate in the dark: almost nobody else knows his way around the subject. If in the past, trade policy had been less opportunistic and more systematic, a greater degree of public control would have been possible. A more systematic policy might be followed with regard to the rate structure or, if that is asking too much, with regard to rate levels. Thus EEC has been able to institute proportional reductions for large numbers of tariff items. Because of the fear of commitment referred to in section 3.2, the American government has not been permitted by Congress to follow this procedure.

The current situation with regard to trade policy is also undesirable because it is doubtful, to say the least, whether highly differentiated tariffs are in accord with the optimum conditions for social welfare.

A case can be made, therefore, for some streamlining, or simplification, of rate structure as advocated by GATT.[1] This would not

1. In the November 1961 Meeting of Ministers held in connection with the 19th GATT Session this view was accepted (see *Conclusions of Meeting of Ministers,* Press

only widen the opportunities for democratic control but would also speed up the processes involved in reducing trade impediments. The present technique of item-by-item negotiation is highly inefficient.

Another requisite for a more systematic trade policy is official recognition of the fact that internal taxes on products are a trade impediment of the same nature as import duties, and subject to the same criticisms. So far there is only the GATT rule prohibiting internal taxes which privilege domestic producers (Article III, 1). Of course, we do not mean that indirect taxes such as general purchase or turnover taxes should be regarded as a major trade barrier; the argument applies to discriminating — and usually rather heavily discriminating — fiscal duties levied on specific products (coffee, cocoa, tea, sugar, etc.). Internal taxes of this kind should be internationally negotiable just as import duties are; they should be brought under the "jurisdiction" of GATT. This fact was recognized in the Havana Trade Charter and in the ITO Charter. The Haberler Report advocates extending the GATT rules so as to cover those internal duties which are comparable to import taxes, a recommendation fully endorsed here.[2]

Since changes in trade policy are bound to affect adversely some groups in the population, they always meet with some opposition. Proposed changes will be more acceptable if they are grouped so that each country will derive advantages as well as disadvantages. Of course, this is more of a problem in the short run; in the long run, interests are more parallel (see section 8.2). Although we are concentrating on the policy of the West as it affects underdeveloped countries, we are thinking in terms of proposals which will fit into a world pattern of changes in commercial policy.

Release GATT/651, Geneva, November 30, 1961). The recommendation of the ministers that machinery be established for considering new techniques, in particular some form of linear tariff reduction, was approved by the Contracting Parties on December 7, 1961. Also, recent proposals of the American government aim at enlarging the powers of the President of the United States in negotiating tariff reductions.

2. See *Trends in International Trade,* Report by a Panel of Experts, General Agreement on Tariffs and Trade, Geneva, 1958, pp. 107–108.

8.2 ETERNAL MYOPIA?

There is a clear difference between the short-term and the long-term effects of a reduction in trade impediments. In the short run a reduction in a tariff or a quota may force an industry into losses; workers may have to be dismissed and capital goods may stand idle. In the long run (that is, if the reduction is only applied after capital goods have been worn out and written off and the workers retrained), unemployed capital and labor can be used in another industry, to the advantage of everybody. Therefore, as a first approximation it can be maintained that in the long run a tariff reduction is in the interest of all concerned: importing countries, consumers, and the erstwhile producers. This is what the theory of international trade has always maintained — and rightly so, at least for industrial countries under the conditions enumerated in section 3.1.

A student of trade policy is soon depressed by the little attention given by politicians to the long-term aspect of economic events. Everyday policy is too much concerned with short-term consequences, and insufficiently aware of longer-term implications which may be favorable. There have of course been notable exceptions to this rule in countries where the free-trade doctrine was well understood. Thus Dutch agricultural policy around the nineties was such that the Netherlands exposed its farmers to the full consequences of cheap overseas grain; it gave them no protection but only support in the form of specialized schools and technical consultation services. It is not by chance that today agriculture is much more efficient in the Netherlands than in neighboring countries.

The tendency to emphasize short-term interests is a general human trait, but this is not to say that it is the course of wisdom. In the case of trade policy it is even less so, since it leads to undue concern for the short-term interests of certain producers; other interests are disregarded. Yet it is true that the idleness of factors of production works a hardship on the nation as a whole. For that reason protection for a transitional period makes sense; it may even

take the form of quantitative restrictions (especially tariff quotas) as a transitional measure.

Yet we cannot respect short-term interests forever. It is against the long-term interests of the population to protect an industry permanently — unless that industry produces vital supplies, as discussed in section 3.1. It is unwise to display myopia in designing trade policy. Protection should be temporary in principle, and be granted at a declining rate so that it will come to an end automatically. To cite an example, when the Netherlands instituted a scheme to promote new industries after World War II, protection was given for three years only, and then stopped. Out of some twenty industries given this protection, three emerged successful; protection to the others was stopped in the general interest. The same philosophy has been followed in the scheme for the Rome Treaty. Here the reductions in intramural protection originally scheduled were gradual, extending over some twelve years. It is a matter of satisfaction that it has been possible to shorten this period by the so-called accelerated execution of the treaty.

In cases where quick action on trade policy is necessary, measures such as the insurance scheme advocated in section 9.4 or increased financial aid may be used to compensate the groups or countries adversely affected. It does seem desirable to act quickly in some cases. Generally speaking the time pattern should be based on the doctrine "first things first." Instruments causing tensions and those least in accordance with the general aims of our policies should be removed first. This applies first of all to quantitative restrictions on industrial products of "low-wage countries," since these are in "flat contradiction to the formal obligations of the importing countries under GATT,"[3] particularly Articles XI and XIII. If imports from these countries cause or threaten serious injury to producers in other countries, the latter are authorized by Article XIX of GATT to take protective measures; this can be settled by agreements between importing and exporting countries. But the protection should not take the form of a long-lasting dis-

3. See E. Wyndham White, *Some Structural Problems of International Trade*, GATT, Geneva, 1961.

crimination, and it should be gradually reduced. ECE has made the constructive proposal[4] that each industrial Western European country "might agree . . . to abolish all tariffs and import restrictions on such exports of manufactures by individual underdeveloped countries as do not, in any year, exceed a certain proportion — say 3 to 5 per cent — of its total imports in the previous year in that commodity group."

8.3 ONE AIM AND SEVERAL ROADS

In order to devise the main lines of action we must further define the aims of commercial policy. To a considerable extent these can be scientifically derived. Our analysis of section 3.1, based on the theories of welfare economics, yields some optimum solutions, best and second best. Trade impediments should be minimal provided that there are sufficient income transfers between wealthier and less well-to-do countries, and that it is possible to organize subsidies for infant industries and industries supplying vital goods. Insofar as these conditions are not met, some kind of protection can be accepted, namely protection of developing countries in a general way, and particularly their infant industries, and protection of vital supplies everywhere. However, the level and duration of the protection applied must be related to the particular object in view. Thus young industries should not be protected by more than the margin that the learning process may be able to eliminate, and for a longer period than the learning process requires. Similarly, the protection of basic industries should be limited by the cost reductions to be expected from economies of scale and external effects once these industries are fully developed. In other words, protection should be reasonable; it should not be simply a type of featherbedding for industrialists.

As to the protection of vital supplies, the whole argument may require overhauling. In Europe it is gradually being recognized that the argument is no longer applicable to small countries, since

4. ECE, *Economic Survey of Europe 1960,* Geneva, 1961, Chapter 5, p. 50.

they will not be isolated in the event of war. What will matter then is only whether a continent as a whole commands sufficient supplies of agricultural products. This can be ensured with relatively lower import duties since there are unexploited productive areas in every continent.

The condition that subsidies be organized for infant and vital industries probably cannot be fully met, and protection will have to be accepted to some extent. The number of units involved and the type of administration necessary for a viable scheme of subsidies are arguments in favor of this point of view. The condition that income be sufficiently redistributed can be complied with, and general protection of underdeveloped countries on this score can therefore be avoided. The rise in income or capital transfers proposed for the future (see section 7.1) seems to meet reasonable standards in this respect. However, until this aid materializes the developing countries will have to take measures to protect their balances of payments. Such measures may include bilateral trade agreements, but they should be considered as a second-best solution only. We do not agree, therefore, with A. Shonfield when he advocates new trade rules for GATT.[5]

What we are left with, then, as a program for trade policy consists of temporary duties or quotas for infant industries in developing countries, perhaps some agricultural protection in industrial countries (to be verified by further research), and temporary protection in the event of sudden changes in competitive conditions.

The central aim of freer trade is not incompatible with controls on trade. It is a question of technique, and the relevant issue is whether or not trade which makes sense from the standpoint of comparative advantages is materializing. In centrally organized economies trade as well as production is the subject of detailed government decisions. Evidently the trade partners of such countries must also have regulations, and these regulations need not impede the development of optimum trade patterns. Whether centralized

5. Andrew Shonfield, *The Attack on World Poverty,* Random House, New York, 1960, p. 56.

decisions are useful even in Communist countries is still another matter.[6]

In addition, the question may be asked whether trade with the Communist countries can be expanded. We think it has been unduly restricted in a number of cases.

The aim of a sounder pattern of international trade can be reached by different roads. One of the conditions determining the choice of route may be — but need not be — that no new discriminations are introduced. This has been the British philosophy for the last ten years or so. The signatories to the Rome Treaty chose to eliminate impediments among themselves first, and then to try to enlarge their group. The establishment of EEC could stimulate the creation of other groups, which might finally merge. Some group arrangements have been accepted by GATT as "legal." The disadvantage of customs unions and free-trade zones is that they may divert trade[7] from more desirable channels. Their advantage is that countries with similar standards and experience in administration can co-operate more easily.

8.4 A WORLD OF AREAS?

There are further arguments in favor of a regional or continental grouping of countries for the purposes of economic policy in general and trade policy in particular. One argument lies on the plane of general organization. Thus the planning, execution, and supervision of a world economic policy could be streamlined and made more efficient by such grouping. Also, groups of neighboring countries often have common cultural elements, sometimes even a common language (as in Latin America and the Arab region). Finally, trade is more intensive as a rule between neighboring countries than between widely separated countries.

6. For some suggestions concerning the conditions which must be satisfied if a centrally planned economy is to comply with the principles of GATT, see E. Wyndham White, *Looking Outwards,* GATT, Geneva, 1960.

7. Jacob Viner, *The Customs Union Issue,* Carnegie Endowment for International Peace, New York, 1950; see also J. E. Meade, *The Theory of Customs Unions,* North-Holland Publishing Company, Amsterdam, 1955.

As a consequence of common cultural elements and regular trade relations, adjoining countries have in many cases a similar way of life, associated with comparable psychological and material needs. Further, they are, on the average, more interested in each other's situation than in the situations of remote countries. These factors can facilitate the conclusion of negotiations and — most important — the execution of common policies. It is true that the mutual interest of neighboring countries may be based in part on fear; historically there have been ardent enemies among neighboring states. The danger of a common frontier without any organizational tie has often led to a merger — frequently accomplished by conquest, but not always. Clearly if adjacent countries enter into communal arrangements, the danger of hostile acts by neighboring states will become weaker. This in turn will make feasible a further approach to co-operation.

The organization argument was discussed briefly in section 7.3 in the context of planning; it applies also to the use of instruments of economic policy. Integration between countries is resulting in the creation of supranational agencies, but their scope is not always world-wide. Continental institutions are being created to serve the ends of financial and monetary policy. Other policies should be co-ordinated at the continental level before world-wide co-ordination is considered. Regional co-operation may become increasingly important in the field of heavy industry. It is a well-known organizational principle that one agency can directly control only a limited number of groups. There are too many nations for them to co-operate efficiently in the world at large. An intermediate role may have to be played by "areas," roughly coextensive with the continents. It must be assumed that the Communist parts of Europe and Asia will act autonomously.

We have already stated that trade within continents is often larger than trade between continents. This will become increasingly true as the developing parts of the world industrialize. Of course, intercontinental trade will always remain. In terms of market areas, commodities can be divided into the following groups:

(i) world trade commodities, those which for the most part

cross continental frontiers (e.g., coffee, copper, oriental carpets);

(ii) semi-world trade commodities, those important in intercontinental trade as well as in trade within each continent (e.g., sugar, several kinds of fruits, cotton fabrics);

(iii) continental trade commodities, mostly traded within the continents (e.g., steel, coal, potatoes);

(iv) nationally traded commodities (e.g., building materials, vegetables); and

(v) locally traded commodities (e.g., bread, repair services).

Although in the course of time the pattern will change and commodities may move from one group to another, it is helpful to make this division for trade policy purposes.

For intercontinental trade it would seem advantageous to introduce an intermediate level of organization. One reason is that it would reduce the number of trade treaties and trade negotiations required. If 100 countries wanted to trade directly with each other on the basis of bilateral agreements, 4,950 trade treaties would have to be negotiated. If they traded directly with each other only within each of five areas of 20 countries and their trade with other areas was dealt with through area organizations, the number of treaties needed would be 1,060, i.e., 10 between areas, 100 between each country and its own area, and 950 between any two countries within the same area.[8]

Finally, important political reasons exist at present for further co-operation within continents or comparable regions. In the existing political situation, the newly independent countries of Asia

8. Of course in practice by no means all international trade is covered by trade treaties. But the argument also applies to trade contacts of other types. Moreover, many developing countries like to embody certain aspects of their trade relations in treaties: it imparts an element of security to their economic structure, and may facilitate their development planning and policy-making. If the principles mentioned above are observed in these treaties, and if they are adapted to changing circumstances at the proper time, they surely may be useful. Area agencies could facilitate this process because they could survey and appraise the economic developments and opportunities in an area better than national governments can. Also, they might reduce the danger of economically unjustified bilateral equilibria becoming a goal of trade policy.

and Africa would probably prefer to make arrangements with EEC as groups rather than individually. Certainly their bargaining power will be greater if they do so. Agreements between areas may then be concluded. Possibly the most far-reaching agreements of this kind could come into being between Latin America and North America, and among the areas of the Old World. In the present chaotic situation in Africa innumerable local political difficulties will have to be overcome before any streamlining is possible; even so, policies may be formulated with this end in view.

The decentralized system of world organization suggested implies an element of competition between areas of comparable strength. Competition of this sort will be sound and stimulating. The guidance of world institutions will be necessary to create and maintain the conditions for balanced area competition. The process will have to be gradual and piecemeal. As an example let us consider the Arab world. In section 3.4 the status of economic co-operation between the Arab League countries was described briefly (p. 54). On the one hand there is an urge to unity and an awareness of the advantages of economic co-operation; on the other, there are many political difficulties, based on differences in politico-economic structure and stage of development.

Because of these difficulties, it has often been suggested in these countries that a start must be made by the formation of smaller groups. These would co-operate with each other on an economic level and, possibly, eventually integrate. Suggestions concerning the size and composition of the smaller groups differ widely. Other people have advocated expansion of direct economic co-operation among all members, but only in a restricted number of economic fields. There is the further possibility that these two approaches could be combined (see Appendix II).

8.5 EUROPE IN THE WORLD

Europe, and more particularly EEC, will exert a considerable influence — for good or ill — by its own activity in the field of trade policies. It will have to show whether it understands its new responsibilities: whether it can be broadminded in designing its own new

pattern, and whether it can be farsighted. Even though the creation of EEC does almost no harm to the outside world at large (see section 3.3), some countries suffer by it. If developing countries feel that they are being unfairly treated, EEC must be careful in discussing with them the sources of tension; it must open up the prospect of better treatment or of compensatory measures.

The most important steps EEC can take are to lower the outer tariff further and to reduce some consumption taxes. We think it is particularly important that the duties or consumption taxes on coffee, tea, sugar, cocoa beans and products, and bananas be lowered, and we suggest schemes for some commodities in later sections of this chapter. Such reductions would have to be accompanied by small increases in the general turnover tax to compensate for the decline in fiscal revenue.[9]

The proposed reductions will effect a corresponding reduction in the privileges promised to associated countries in the form of higher prices for their products. Here we have a case in which compensation must be offered.[10] The most appropriate form which compensation can take seems to us to be an additional amount of financial assistance for development purposes. More precisely, this amount should correspond to the reduction in export values to be expected from the reduction in outer tariffs applied to outsiders. The case can be illustrated by hypothetical figures.

Suppose a reduction in the outer tariff on an important export article of an associated country is expected to diminish the total annual export proceeds of that country by $12 million. The tariff reduction will be put into effect in six equal steps in the course of six years; every year, then, a decrease in export value of $2 million will occur. Marginal producers of the commodity will have to cease operations and attempt to switch to other occupations. Development plans will have to be reconsidered and efforts may have to be made to introduce new branches of production. If after the

9. Some estimates of the order of magnitude of the decline in fiscal revenue and of other consequences of a lowering of tariffs and internal taxes are presented in the next section and in Appendix VII.

10. See *La politique de la CEE à l'égard des pays en voie de développement* (Colloque de Bari, October 1961), Comitato Nazionale per l'Energia Nucleare, Rome, 1961.

period of six years the export value of new articles is, say, $8 million and production for home consumption of commodities formerly imported amounts to $4 million, a new equilibrium will have been attained.

The following schedule of assistance for development purposes may be imagined:

Millions of Dollars

Year	*Financial Assistance*	*Increase in Production as a Result of Assistance*[a]	*Decrease in Exports of Less Protected Commodity*
1	6	—	—
2	6	2	2
3	6	4	4
4	6	6	6
5	6	8	8
6	6	10	10
7	—	12	12

a. Here a capital-output ratio of 3 years has been assumed, leading to an annual increase in production of $\frac{6}{3} = 2$.

This simple example may be made more complicated at will. The gestation period of newly invested capital can be figured at more than 1 year; if this is done the assistance must be higher in the early years to prevent balance of payments deficits. The total amount needed in the form of additional financial assistance will be three times the annual value of the privileged exports to be replaced, this ratio coinciding with the capital-output ratio for additional investments.

If an international scheme for insurance against the risks of declining exports — as mentioned in section 4.5 — could be effectuated, member countries might receive part of any compensation due them from the insurance fund.[11] In this connection, the establishment of a special EEC insurance fund which might later be integrated into a world-wide insurance scheme could be considered.

11. See also section 9.4.

A world body might act as an overseer for a number of area insurance systems.

If EEC were to reduce its outer tariff, as suggested above, the prices at which European industrial products are supplied to associated territories could be reduced at the same time. At present industrial products are supplied by France at higher than world market prices, but these products can be supplied by other member countries at world market prices.

EEC will also have to decide on its future policies of association. Association with Turkey is under way, and association with a number of African countries must be negotiated anew before the current association treaties expire on December 31, 1962. Association of individual countries seems a natural development when these countries are potential members, as is true more particularly of European countries. As we have said, for non-European countries area agreements are preferable in principle. But until such areas exist, the privilege of individual association must be continued. In these circumstances some of the preceding considerations regarding compensation for reduction in privileges apply.

Many details will take shape only after negotiations with the United Kingdom are further advanced. Two major sets of problems will have to be solved during these negotiations: relationships with the Commonwealth, and agricultural policy. With regard to the Commonwealth countries on the one hand and the associated territories of EEC on the other, it is natural to think that both groups of countries would be placed in the same position in relation to the joint market of EEC and the United Kingdom. Since the Commonwealth countries do not export the same class of goods as the EEC associated territories, different treatment of different commodities will have to be instituted to establish some sort of equilibrium.

8.6 SUGGESTIONS FOR A TRADE POLICY

We must bear in mind that the ultimate aim of international trade policy is the liberalization of world trade, except in the cases

mentioned in section 8.3. As explained above, there is a place for area co-operation in the context of world economic integration. However, developments in this respect have been out of balance: Western Europe is far ahead. For the present this means that special discriminations against outside countries are in force. Because of this situation it seems wise to consider the future integration process of the Western European countries (including their relations with the associated countries and the Commonwealth[12]) against the background of Western Europe's relations with the rest of the world. In other words, in studies and negotiations on the dismantling of trade impediments between Western countries, attention should constantly be given to the position of the outside countries. It would also help to bring about a balanced treatment of the problem if we distinguished groups of commodities according to their relative importance, not only to the EEC countries and their Associates, the United Kingdom and the Commonwealth, but to the outside countries as well.

With regard to import duties we suggest that as a rule they should be proportionally reduced for all commodities of one group. The agreed-upon EEC outer tariff for these commodities would be reduced by the same percentage, the reduction to be accomplished gradually, and the level aimed at in our provisional plan to be attained at the end of the transition period, December 31, 1967 (see Appendix VII). The result would be a common outer tariff for EEC and the United Kingdom. Exports from the Associates and the Commonwealth to EEC and the United Kingdom would be duty-free. The same would apply to any other European countries that might join the extended Common Market. Exports from EEC and the United Kingdom to the associated countries and the Commonwealth would be duty-free too, unless industrialization problems or balance of payments difficulties made protection imperative (these are the exceptions mentioned in the EEC treaty).

In other respects, however, the commodities of one group would

12. As used in this section, Commonwealth excludes the United Kingdom.

have to be dealt with in different ways. This applies, for instance, if a shift in the production pattern of a single commodity – due to the lower import duty – has to be compensated for by special aid to one or more exporting countries. Also, some regulations concerning tariff quotas might have to be made. It is conceivable too that, after being maintained for a short period, import quotas would be gradually enlarged. Where the system of selling contracts exists, it seems desirable that limited periods of maintenance and normal prices be indicated in the contracts. Finally, we think that in many cases internal taxes should be reduced in order to encourage consumption in developed countries and increase the export possibilities of developing countries.

There might be exceptions in each group, "special cases" in which the decrease in import duties could only be different from the general run. It is also to be expected that in some cases no agreement as to import duties will be reached by EEC and the United Kingdom, so that the commodities in question cannot be subject to the same procedure. In such cases we can only hope that the differences will eventually be smoothed out.

If a commodity is of especially great importance to outside countries it should be considered a candidate for the greatest decrease in European preferences. Striking differences between the protective duties on a commodity in its successive processing stages should be reduced. This must be done carefully in order to enable the industry concerned to switch to another line of production if necessary.

To illustrate our train of thought we will set down a tentative scheme of commodity groups, and then consider a representative commodity from each group. Thus we will try to arrive at proposals for tariff reductions which could be acceptable to all concerned, exporting as well as importing countries.

It goes without saying that if area association is speeded up in other parts of the world, European trade policy will have to adapt itself to the new constellations.

In accordance with the design of this book, we have included in

our proposals those commodities which are of great importance — or at least of special interest — to developing countries. Our suggestions are in line with the developments we recommend in world trade policy.

The groups to be distinguished are:

I. Commodities very important to outside countries, important to the Associates, also produced in the Commonwealth (e.g., coffee). Because of the great importance of these commodities to outside countries the decrease in the EEC outer tariff will have to be large. We propose 80 per cent.

II. Commodities very important to outside countries, important to the Commonwealth, also produced in the Associates (e.g., bananas and beef). As in group I, and for the same reason, we propose a tariff reduction of 80 per cent.

III. Commodities very important to outside countries, and also important to EEC and Associates and to the United Kingdom and Commonwealth (e.g., sugar). A number of these commodities are vital for Western Europe, so this area must continue to produce them to a certain extent. But as they are highly important to outside countries we propose a reduction of 70 per cent.

IV. Commodities very important to the Commonwealth, also produced in outside countries, but of slight importance to the Associates (e.g., tea). Notwithstanding the great importance of these products to the Commonwealth, the United Kingdom general tariff — and the Commonwealth preference — is in many cases not very high. In order to reach an agreement with the United Kingdom, EEC must lower the planned outer tariff significantly. The fact that these products are more important to outside countries than to the Associates also makes such a reduction reasonable. We propose 70 per cent.

V. Commodities very important to the Commonwealth, also produced in outside countries and in the Associates (e.g., cocoa beans and palm oil). As in group IV, the great interest

of the Commonwealth argues for a considerable decrease in the outer tariff. But because these products are more important to the Associates than those in the preceding group, we propose to restrict the reduction to 60 per cent.

Groundnuts, which also belong to this group, will not be subject to an EEC import duty; therefore, if the United Kingdom joins the Common Market, the Commonwealth preference of 10 per cent will disappear.

VI. Commodities important to outside countries, to the Commonwealth, and to the Associates, and of some importance to the United Kingdom and EEC (e.g., dried fruits). A certain degree of self-sufficiency in these products is often useful to Western Europe. In most cases the planned EEC outer tariff is not extremely high. A decrease of 60 per cent would therefore bring the outer tariff to a reasonable level, and give outside countries a fair chance to compete in the European market.

VII. Commodities important to outside countries, to the United Kingdom and the Commonwealth, and to EEC and the Associates (e.g., cotton fabrics). Since on the one hand the EEC countries frequently seem to have overprotected their own producers and on the other hand products of this group often have the character of vital supplies, a decrease of the outer tariff by 50 per cent might be justified.

The reductions in the EEC outer tariff suggested for the various groups of commodities are listed in Table 8–1. A detailed discussion of the market situation and the import duties at present levied on these commodities will be presented in the next section. First, however, we will examine briefly the consequences of such a program of tariff reductions for the economy of the country lowering or abolishing duties.

Table 8–2 summarizes the results of a calculation of the consequences of a complete abolition of all the taxes and duties that are levied on the import and consumption of a few commodities. The method of calculation is set out in detail in Appendix VII. The

Table 8–1

PROPOSED PERCENTAGE REDUCTIONS IN EEC OUTER TARIFF FOR SEVEN GROUPS OF COMMODITIES, WITH EXAMPLES
(to be realized by December 31, 1967)

		Commonwealth, excl. United Kingdom			
		Less Important	Important		Very Important
		EEC Associates			
		Important	Less Important	Important	Less Important
Outside Countries	Very Important	I 80 (coffee)	II 80 (bananas)	III[a] 70 (sugar)	
	Important			VI[b] 60 (dried fruits) VII 50 (cotton fabrics)	
	Less Important				IV[c] 70 (tea) V 60 (cocoa beans)

a. Also important to the United Kingdom and EEC.
b. Of minor importance to the United Kingdom and EEC.
c. Of hardly any importance to EEC Associates.

Table 8–2

ESTIMATED EFFECTS OF ABOLISHING ALL IMPORT AND CONSUMPTION CHARGES ON SELECTED COMMODITIES (1959 data)

	INCREASE IN IMPORTS AS A PERCENTAGE OF TOTAL IMPORTS			LOSS OF GOVT. REVENUE AS A PERCENTAGE OF TOTAL INDIRECT TAXES		PERCENTAGE DECREASE IN PRODUCTION AND EMPLOYMENT IN INDUSTRY CONCERNED (UPPER AND LOWER ESTIMATES)	
	Coffee, Tea, Bananas	Sugar	Cotton Grey Goods	Coffee, Tea, Bananas	Sugar	Sugar Production and Refining	Cotton Textile Industry
BLEU	—	0.4	0.6	0.2	1.2	72–100	8–11
France	0.2	2.3	1.8	0.7	0.9	80–100	11–15
Germany (F. R.)	0.3	n.a.	0.7	2.5	0.5	n.a.	4–6
Italy	0.4	3.2	n.a.	2.1	3.5	82–100	n.a.
Netherlands	—	0.8	0.5	0.3	6.4	72–100	7–9
Austria	—	2.5	0.9	0.4	1.8	66–100	13–17
Denmark	0.1	0.6	0.1	1.5	—	40–60	4–5
Finland	0.1	0.1	n.a.	7.3	3.8	96–100	n.a.
Norway	—	—	0.1	0.1	0.3	—	6–8
Sweden	0.1	n.a.	0.3	0.9	1.5	n.a.	6–8
Switzerland	0.1	0.1	n.a.	1.4	2.3	47–70	7–9
UK	—	n.a.	0.6	0.9	2.3	n.a.	7–10
Canada	—	0.1	n.a.	0.1	0.5	37–55	n.a.
USA	—	0.5	n.a.	—	0.3	15–22	n.a.
Australia	—	—	n.a.	0.1	n.a.	—	n.a.
New Zealand	—	—	n.a.	0.3	1.0	—	n.a.
Japan	—	0.5	n.a.	1.6	5.4	70–100	n.a.

—: nil or negligible.
n.a.: not available, i.e., impossible to estimate.
Sources: See Appendix VII.

commodities chosen are all important export products of several developing countries. They fall into three categories:

(i) agricultural products not directly competing with production in developed countries (e.g., coffee, tea, bananas);
(ii) agricultural products competing with production in developed countries (e.g., sugar); and
(iii) industrial products competing — almost by definition — with production in developed countries (e.g., cotton grey goods).

The consequences of abolishing all import and consumption charges cannot easily be assessed; a crude estimate was the most that could be arrived at in the present study. An attempt has been made to quantify, for a number of countries, three different effects of an abolition of charges, namely:

(i) the increase in imports;
(ii) the loss of government revenue; and
(iii) the decrease in production and employment.

Obviously these effects will be regarded unfavorably by the country concerned, albeit to a varying degree. The loss of government revenue will not be taken too seriously in most countries, as this loss can easily be compensated for by a modest increase in other tax rates. The decrease in employment (which is, to be sure, only a short-term effect) will probably be regarded as a more serious threat of the increased competition of foreign goods in the domestic market.

It should not be overlooked, however, that there are consequences of a positive nature as well. These positive consequences have not been estimated quantitatively here, but they are tangible. To mention only the most immediate beneficial effect, consumer prices of the commodities involved will be lowered, which means of course a higher income and consumption level in terms of goods.

The following conclusions may be drawn from the figures in Table 8–2. It appears that a simultaneous abolition of all duties and taxes on coffee, tea, and bananas would have little effect on the balance of payments of the importing countries. But if similar

measures were taken with respect to sugar, the increase in imports would be more pronounced in several countries. In the case of cotton grey goods the import increase to be expected is fairly modest for most countries.

The impact on government income is unimportant. Even if a loss of receipts of 10 per cent of total indirect taxes were to result, this could be offset by raising the general turnover tax rate from, say, 4.0 to 4.5 or 5.0 per cent (depending on the importance of the turnover tax relative to total indirect taxes).

The estimated decrease in production and hence in employment would be much greater in the sugar industry than in the cotton textile industry. A complete abolition of import duties on sugar might result in the cessation of all production in Western Europe and Japan. To the extent that some domestic production is considered essential, less drastic measures than a full abolition would be called for. In the next section we propose that import duties be lowered by 70 per cent only; this reduction should be put into effect gradually, and measures should be taken to ease the adaptation process.

The consequences of an abolition of duties on cotton grey goods would be less serious. The resulting decline in production and employment would be around 10 per cent in most countries, and only modestly higher in countries with relatively high tariffs. As this decline would be spread over a period of at least six years, the annual incidence would not exceed 2 or 3 per cent. Particularly in a period of general economic expansion and full (or even overfull) employment, the adaptation process would not be a very painful one.

It should be borne in mind that the effects set forth in Table 8–2 would follow only from the most ambitious and drastic measures that could be taken — that is, a complete abolition of both import duties and internal taxes. The program of tariff reductions outlined in Table 8–1 and to be discussed in detail in the next section would have more limited consequences. The present analysis has shown that, except for sugar, these consequences are such

that they can certainly be borne by the economies of the developed countries, especially if measures are taken to overcome temporary difficulties in the industries that are affected.

8.7 ILLUSTRATION OF A TRADE POLICY FOR GROUPED PRODUCTS[13]

GROUP I *Proposed reduction of EEC outer tariff: 80 per cent*
Example: coffee

In many respects the position of coffee is serious; overproduction exists and moreover the economies of a number of developing countries that produce this commodity are threatened with stagnation. The success of the International Coffee Agreement has been demonstrated by the virtual cessation of price deterioration since 1958 for the varieties produced by the member countries. However, the situation requires permanent attention; coffee producers must intensify their co-operation. Production must be kept within reasonable limits, and consumption will have to increase.

The United Kingdom levies a general import duty on unroasted coffee with an incidence of about 4.5 per cent, and a preferential tariff for the Commonwealth with a 1.5 per cent incidence. The future EEC outer tariff will be 16 per cent. In several Western European countries — Germany and Italy for instance — fiscal duties on coffee are extremely high.

A cut of 80 per cent in the EEC outer tariff — resulting in a tariff of 3 per cent — would give significant impetus to consumption. So would a considerable reduction in European internal taxes. The latter measure would be important to all exporters; the former would be advantageous to outside countries, the largest coffee producers, especially Brazil. The African Associates, also important producers, would be less protected. Where necessary they might be given compensatory development aid. For a limited period of time, for instance two years, France could be allowed to buy fixed quantities of coffee from the Associates; later these quantities would have to be reduced. Prices would have to be lowered to a normal level, as would the prices of certain French industrial goods exported to the African Associates. The French quantitative restrictions on outside coffee would have to be gradually abolished.

Together these measures are expected to encourage coffee consump-

13. Main sources: *The Commonwealth and Europe,* The Economist Intelligence Unit, London, 1960; and *Trends in International Trade,* cited in footnote 2.

tion. Without a successful agreement between producing countries, however, they could only lead to undesirably intense competition between producers all over the world. Therefore, efforts to promote regulation of production and trade, price stability, and increasing coffee consumption, together with investment aid when needed, should be effectively co-ordinated. This will require close contact between the members of the Coffee Agreement, the EEC countries, including the United Kingdom, and the United Nations agencies concerned.

GROUP II *Proposed reduction of EEC outer tariff: 80 per cent Example: bananas*

The incidence of the United Kingdom tariff on bananas is 12 per cent, the same as the Commonwealth preference. The future EEC outer tariff is fixed at 20 per cent. Germany has tariff-free quotas at least during the transitional period of EEC. France buys African bananas at prices above the world level. The Italian state monopoly gives special privileges to Somalian producers.

Central America, Colombia, Ecuador, and the Canary Islands are the chief producing countries. Of secondary importance are the Commonwealth countries, followed by the Associates.

Production is expanding rather fast; new production schemes are under consideration. Demand in importing countries is increasing, but whether it will be able to keep pace with production is questionable.

If the EEC outer tariff of 20 per cent should become a reality, there would be a strong incentive to expand production in the Associates, a development which might strengthen the tendency to world overproduction. This would work a hardship on the outside countries which have no preference at all.

An 80 per cent reduction would bring the outer tariff to 4 per cent. The banana-producing countries among the Commonwealth and associated countries could be awarded compensatory development aid. Discrimination against the Latin American producing countries, which constitute by far the biggest production region, would be substantially diminished. Although there would remain a European tariff of 4 per cent, this does not seem an unsurmountable trade barrier. The Latin American producers, moreover, have easy access to the United States, which levies no duties at all. It is hoped that when Latin American integration has made further progress the high Brazilian import duty of 80 per cent will soon be reduced.

It has been suggested that France and Italy be permitted to continue buying fixed quantities from the Associates during a certain period, for

instance two years; thereafter, however, these quantities would have to be reduced. Prices should be dealt with as in the case of coffee.

It might be useful to consider the possibility of an international agreement which would prevent an excessive extension of production and promote a more even distribution of production.

GROUP III *Proposed reduction of EEC outer tariff: 70 per cent*
Example: sugar

Sugar, too, belongs to the semi-world trade commodities. Western Europe and the United States are important producers, ranking next to the West Indies (mainly Cuba) and Central and South America. Other main producing areas are India, Australia, and the Philippines. In Africa, the Union of South Africa and some of the African EEC Associates deserve mention.

The EEC countries have a large domestic sugar production. Western Germany and the Netherlands are net importers; France, Italy, Belgium, and Luxembourg net exporters. Together the Six have a bare net import balance. The main suppliers are the Latin American export centers, though France imports mainly from the Associates. Consumption in the Six is severely hampered by the high level of taxes and by government price fixing. If these impediments were substantially diminished or abolished, consumption could be expected to increase significantly; domestic production would not be able to keep pace.

The future EEC outer tariff on sugar will be 80 per cent. The general incidence of the United Kingdom tariff can be roughly calculated at 30 per cent and the preferential duty on Commonwealth sugar at 9 per cent. Of the United Kingdom's imports 60 per cent originate in the Commonwealth; other important suppliers are Cuba and the Dominican Republic. Trade between the United Kingdom and the Commonwealth is covered by the Commonwealth Sugar Agreement, according to which the United Kingdom imports large quantities of sugar at prices substantially above the prevailing world market level. To date the Commonwealth has not sold in the EEC market.

The world sugar market is permanently threatened by export surpluses. But free-market prices have been reasonably stable since the International Sugar Agreement came into force. This agreement covers the "free market," which is that part of the international sugar market not covered by special arrangements, excluding among others the large trade covered by the Commonwealth Sugar Agreement and all imports into the United States. Even within the free market, a considerable amount of trade takes place on a bilateral basis (private or govern-

mental). We think that an extension of the field of action of the International Sugar Agreement is very desirable from the standpoint of the world sugar trade.

On the consumption side, material reductions in duties and taxes are essential conditions for increasing demand.

In summarizing, we would like to make the following recommendations:

(i) Sugar should not be excluded from the negotiations between the EEC countries and the United Kingdom, as is sometimes suggested. Instead the Commonwealth should be given free access to the market of the Six, and the common outer tariff of 24 per cent (the result of a 70 per cent reduction in the planned EEC outer tariff of 80 per cent) for the United Kingdom and EEC should be accepted. This would be favorable to outside countries but would not bear down too heavily on European domestic production.

(ii) Domestic fiscal charges should be drastically reduced.

(iii) The United Kingdom should submit to the regulations of the Sugar Agreement. If necessary for purposes of agreement, provision must be made for the protection of Commonwealth interests — for example, by special quota restrictions on non-Commonwealth imports into the United Kingdom.

(iv) In special cases provision of compensatory aid should be considered.

A more balanced pattern of world production and trade may be expected in this way.

GROUP IV *Proposed reduction of EEC outer tariff: 70 per cent*
Example: tea

The United Kingdom levies a general import duty on tea with an incidence of about 4 per cent, but imposes no duty on tea imported from Commonwealth countries. The future EEC outer tariff will be 18 per cent, which is considerably below the arithmetic average of the duties of the member countries. Fiscal charges in Germany are very high, with an incidence of 74 per cent; in the other EEC countries they vary from zero to 12 per cent.

In general the world market shows a tendency toward oversupply. Up to now, however, no steps have been taken to renew the International Tea Agreement, though the International Tea Committee has a permanent character. By far the largest producers are located in the Commonwealth, especially India and Ceylon, but fairly important pro-

ducers are found among the outside countries, e.g., Indonesia, China, and Japan; little production comes from the Associates.

The effect of EEC will be to stimulate production in the Associates, and this does not seem advisable in view of the general market situation. A considerable improvement could be effected by reducing the outer tariff by about 70 per cent to 5 per cent, which is about 1 per cent higher than the incidence of the United Kingdom specific duty. This outer tariff of the extended Common Market would be equal to the Commonwealth and Associates preference. Discrimination against the outside countries would be substantially reduced. If the economies of certain Associates should be unfavorably affected, there might be room for counterbalancing development aid.

The reduction of the EEC outer tariff to the level proposed should be accompanied by the elimination of fiscal duties in the European countries. This would be of special importance with regard to Western Germany (which has a duty of 74 per cent), the biggest tea-consuming country in Western Europe after the United Kingdom and the Netherlands.

GROUP V *Proposed reduction of EEC outer tariff: 60 per cent*
Example: cocoa beans

Cocoa beans are produced in tropical countries, and consumed mainly in countries in the temperate zone of the Northern Hemisphere. The principal producing countries are, first, the Commonwealth members Ghana (about one-third of world production) and Nigeria, and second, the Latin American countries Brazil, Ecuador, and Venezuela. West African Associates are also important producers.

The planned EEC outer tariff on cocoa beans is 9 per cent. The United Kingdom specific duty has an incidence of about 5.6 per cent,[14] and the Commonwealth preference amounts to about 1.1 per cent. Several European countries levy high internal taxes on cocoa products, especially finished chocolate. After a postwar shortage which strongly stimulated production, the present market position of cocoa is not encouraging, unless consumption can be stepped up. There is more scope for a rise in consumption per head in continental Western Europe than in the United Kingdom and the United States, which are nearer to the saturation level.

A reduction of 60 per cent in the future EEC outer tariff would

14. Incidences are approximate since they are based on import values of selected years, in general 1957–58 or 1958–59. The import duties used in this section are those fixed formally by the governments concerned; actual duties may be somewhat different. This may explain why our figures do not always coincide with those of EEC as shown in Appendix I, p. 207.

bring it to 3.5 per cent. If EEC and the United Kingdom merge, the most important producers, the Commonwealth countries, would be accorded more preference in the United Kingdom market because they would have no more duty to pay on entering the United Kingdom. Specifically, the preference would go from 1.1 to 3.5 per cent. In the EEC market they would be on an equal footing with the Associates, with a preference of 3.5 per cent. Discrimination by EEC against Latin American producers would be diminished significantly. The big consumer in the Western Hemisphere, the United States, levies no import duties at all.

The position of the Associates, on the other hand, would deteriorate as they would be expecting a preference of 9 per cent. Free entry into the United Kingdom market would not be of much importance to them, but if other European countries joined the extended Common Market this might provide new opportunities. It would be wholly justified to give compensatory development aid to those Associates that met with difficulties.

A second measure we suggest is a substantial decrease in the high internal taxes on cocoa products. This would encourage consumption and thus benefit all the producing countries.

Finally, we hope that the international discussions with regard to an international agreement for cocoa will meet with success. Because of the long time it takes to grow a tree and its long productive life, there is danger of serious error in estimates of future supply. Events since 1945 may be a reflection of this.

GROUP VI *Proposed reduction of EEC outer tariff: 60 per cent*
Example: dried fruits

Dried fruits — raisins, currants, dates, and others — belong to the group of semi-world trade commodities (see section 8.4). In all continental areas there is room somewhere to produce dried fruits under more or less favorable conditions. The importing continents will have to consider to what extent they wish to rely on their own production, and to what extent the interests of underdeveloped exporting countries must be respected.

The EEC countries import dried fruits from Greece, Turkey (a probable future EEC Associate), North African countries, Iraq, Iran, and the United States; Afghanistan is a potential supplier. United Kingdom imports come for the most part from Australia and South Africa.

The EEC outer tariff will range from 9 per cent (for raisins, currants, etc.) to 12 per cent (dates, etc.), the only exceptions being the 18 per

cent tariff on prunes and the tariff ranging from 8 to 20 per cent on dried citrus fruits (most of the citrus fruit is imported fresh, however). The United Kingdom general tariff varies from nil (for, among others, pitted dates and the cheaper kinds of unpitted dates, and prunes) to 15 per cent (among others, figs and citrus fruit), the tariffs on the more expensive unpitted dates being 10 per cent. The incidence of the specific duty on raisins amounts to nearly 7 per cent, on currants to about 2 per cent. Commonwealth dried fruits enter duty-free.

A reduction of 60 per cent in the EEC outer tariff would result in a tariff generally ranging between 3.5 and 5 per cent. This would mean that a small margin of preference would be left to Greece and the future Associate, Turkey. The exports of these two countries together with some local production in the other EEC member countries would be a guarantee that Western Europe would to a certain extent be self-supporting. (In times of scarcity dried fruits may be a welcome and easily obtained food.) Exports of South Africa and Australia would be most exposed to the increased competition. On the other hand, the less developed North African and Southwest Asian countries would benefit. The fact that the United States export position would also improve might stimulate these underdeveloped countries to improve the quality of these export products.

There are cases in which a 60 per cent reduction in the EEC outer tariff for the extended Common Market would result in an increase as compared with the present United Kingdom tariff. The most striking case would be prunes; a 7 per cent tariff would be instituted whereas now they are duty-free. In the case of pitted and the cheaper unpitted dates, the difference between the EEC outer tariff and the United Kingdom tariff amounts to 5 per cent (the United Kingdom tariff incidence being 2 per cent, and the reduced EEC outer tariff 3.5 per cent). These might be cases in which exceptions to the rule of proportional reductions in the EEC outer tariff for all the commodities of a group could be considered. It might be advisable to reduce the tariffs on these products by more than the proposed 60 per cent since strengthening of the preferences given by one of the two negotiating parties should be avoided as much as possible.

GROUP VII *Proposed reduction of EEC outer tariff: 50 per cent*
Example: cotton fabrics

The main producers of raw cotton are the United States (responsible for nearly 50 per cent of all non-Communist world production in 1959), India, Pakistan, the United Arab Republic, and Brazil. Together they

account for about 75 per cent of the raw cotton produced in the non-Communist world. Cotton fabrics are produced mainly in the United States, Western Europe, India, Pakistan, Japan, and Hong Kong, which together represented about 80 per cent of world production in 1959. Both the production and the processing of cotton are gradually spreading over a wider geographic area.

As to international trade in cotton fabrics, Western Europe represents about two-fifths of the imports and exports of the non-Communist world; its export surplus is small, a remnant of an impressive surplus at the time of the First World War. The United States share in the international cotton trade is rather small. The main exporting areas besides Europe are, since the thirties, Japan (about 25 per cent of total exports in 1959), and since the end of the forties, India (nearly one-sixth of total exports), Pakistan and Hong Kong.

Cotton fabrics are a striking illustration of the problem of future coexistence between the Eastern and the Western world in the sphere of industrial development. With regard to cotton fabrics a dynamic adaptation process is in full flower. There is a tendency in Western Europe to reduce productive capacity, and at the same time to concentrate on quality production. The industry meanwhile is concentrating ever more on the European market, and a reorientation is taking place with regard to outside markets. On the other hand, the cotton industry in Asia is expanding and there are shifts in production and export relations, occasioned by such factors as the growing importance of mainland China. Recently the United States, too, has experienced greatly increased imports of cheap cotton fabrics from the East, in spite of its relatively high import duties. This world-wide adaptation process could be furthered by a well-balanced Western trade policy. We think that a merger between EEC and the United Kingdom, and probably other European countries, is of primary importance, for it would free the Western European cotton industry from the worst ravages of outside competition and enable it to find its optimal structure. This in itself would permit a more tolerant attitude toward the liberalization of trade policy.

The projected EEC outer tariff on cotton yarn is 10 per cent. The United Kingdom tariff is 7.5 per cent, while imports from Commonwealth countries are duty-free. For cotton cloth these figures are 17 per cent for EEC, and 17.5 per cent for the United Kingdom, equal to the Commonwealth preference. It would appear that the United Kingdom is exposed to the unlimited competition of Hong Kong, India, and Pakistan; so far, however, this competition has been limited by voluntary export restrictions by these three countries.

We noted in Chapter 3 that in 1961 a "short-term agreement" was concluded by a number of importing and exporting countries in the context of GATT (see p. 49). This agreement was recently followed by a longer-term agreement which provides for a doubling of the EEC quota in the next five years. Some comments on the situation may be appropriate.

To begin with, trade in cotton fabrics is becoming more and more a matter of East-West trade, for which special lines of conduct may be needed, though here too an increase in nonstrategic commodity trade seems desirable. Trade between non-Communist developing countries and developed countries should be expanded in any case, however, and the expansion planned in the agreement is disappointingly modest. To be sure, total trade in cotton fabrics is larger than the quotas indicate, since some items are not regulated by quotas. It is also apparent that some European countries, like Great Britain, have had a considerable reduction in exports and so have played their part in accepting structural changes advantageous to Asian countries. Countries like the United States, which never had large exports, and France and Italy, which are particularly restrictive at the moment, should also make a contribution to a more economic pattern of trade.

European textile producers fear that their product is the focal point of the export drive by the developing countries and hold that this justifies the rather strict regulation of their market. The history of Japan shows, however, that the industrialization process tends to spread to other industries, thus automatically distributing the pressure. Moreover, textile markets do not exhibit the typical features of unstable markets which require regulation (see section 4.2). We do not think, therefore, that such regulations deserve further application. Some attempt at international planning of investments should be made, based on studies of comparative advantages and on the notion of diversifying production in developing countries, following the example of Japan.

While provision must be made for temporary disruptions, these protective measures should be short-lived, and the general trend should be toward a lowering of trade barriers. Reduction of the EEC outer tariff by 50 per cent would result in a tariff of 5 per cent on cotton yarn and 8.5 per cent on cotton cloth. This would mean a substantial decrease in the Commonwealth preferences and at the same time a closer approach between the tariffs on yarn and cloth.

CHAPTER 9

FINANCIAL AND MONETARY SYSTEMS AND STABILITY

9.1 ROLE OF FINANCIAL AND MONETARY POLICIES

Each country has a financial and monetary system which plays an important part in its economic order. The system has two poles, the central bank and the treasury. The central bank mainly carries out monetary policy and the treasury conducts financial policy. In modern terminology we may characterize these two institutions as dealing respectively with the stock of money and the flow of money. Responsibility for the quantity and quality of the monetary circulation was felt much earlier than responsibility for the maintenance of a certain flow of money transactions. In most countries central banks were given charters enabling them to assume this responsi-

bility. In a period when competition was highly valued as an efficient mechanism, these charters gave central banks a *de facto* monopoly on the emission of notes. Originally central banks were to be mainly "lenders of last resort," a source of help in emergencies. Later they were more permanently engaged in maintaining a specified relation between their gold stock and monetary circulation, i.e., the quantity of money in circulation.

Much later, after the depression of the thirties, it came to be understood that the treasury could exert a considerable influence on the money flow – that is, on the total demand for goods and services – by manipulating total public expenditure and taxes. In fact, the most important lesson learned during the great depression was that total demand cannot be influenced very much by indirect instruments such as interest rates and other credit conditions.

Today if we want to rethink the operation and organization of our financial and monetary system, the first point to be made is that the flow of money is more important than the stock of money. It is the flow which determines the volume of production and is the source of material well-being. We can observe that the relation between money flow and money stock is a loose one, especially in the short run. Only severe restrictions on new credits have any direct influence on the flow of total demand; other instruments of monetary policy are of secondary importance, as already observed.

The main aim of financial and monetary policy must be to attain a steady growth of demand with a stable price level, that is, to avoid either inflation or deflation. The classical ideas about the best operation of the monetary system overemphasized the importance of maintaining a fixed ratio between money stock and gold stock, for the sake of creating confidence in the monetary unit. The classical "rules of the game" – which prescribed that international payments be made as much as possible in gold and that money circulation be adapted to gold stock – would, however, work unfavorably in certain circumstances. In fact, a country with a balance of payments deficit had to cure itself – according to these rules – by contracting activity rather than by reducing prices, which is the proc-

ess actually needed. The maintenance of a rigid ratio between money and gold cannot therefore be considered a wise policy for treating short-term disturbances.

In the longer run a certain ratio between gold stock and money stock is desirable, as a basis for confidence. But the ratio cannot be constant if we wish to keep the average price level constant. Gold stocks have increased over the centuries less than production. Monetary systems have adapted themselves by letting the same stock of gold "cover" an ever increasing quantity of money. This was done partly by increasing the share of bank deposits in the total monetary circulation. Today the gold stock normally serves as "cover" in two ways. In the balance sheet of the central bank it "covers" a certain percentage of central bank notes circulating with consumers, plus deposits held by private banks at the central bank. In the balance sheet of the private banks, deposits at the central bank "cover" a certain percentage of private deposits, which therefore are only indirectly and to a much lesser extent covered by the central bank's gold. It is in part this system of a "second floor" which makes it possible for the same gold stock to cover a much larger circulation of notes plus private deposits than formerly. While the monetary system must, in the longer run, try to maintain a certain ratio between gold and money stock, the optimum ratio is not a constant one. So far it is because of incidental changes in structure that no shortage in liquidity has developed.

The maintenance of healthy conditions in the monetary sphere remains one of the basic tasks of our financial-monetary authorities. But, as was already noted, regulation of the money flow is more important than regulation of the money stock. Thus a correct financial policy is more vital than a proper monetary policy, and the role played – for good or ill – by the treasury is of the utmost significance.

It follows that genuine and wholehearted co-operation between the "two poles" is necessary: contradictory policies are intolerable. That being the case, the government must have the last word in any conflict between the central bank and the treasury: there can-

not be two captains on one ship. At the same time, this final responsibility puts a heavy obligation on the government. Not all governments have been sufficiently aware of the role they should play, and this explains why central bank experts and others tend to favor an independent central bank.

9.2 THE NEED FOR FINANCIAL AND MONETARY WORLD AGENCIES

The complex of financial and monetary policies adopted by any single country is of primary importance not only for the well-being of that country but also for the well-being of other countries. This is why a considerable degree of centralization in the world's (or at least the non-Communist world's) financial and monetary policies is indispensable. National autonomy in this matter cannot be accepted as a healthy condition, for mistakes made in national policies will inevitably have consequences extending beyond national frontiers. Some forms of consultation between governments, with which we have had experience, have been useful. Conferences should be carried out at the ministerial level rather than by their aides, in order to strengthen the commitments made. But a weak form of centralization, such as simple consultation, is not enough. The reason we have not made more progress is the undue respect our world has for national autonomy — at least in the developed countries. A much stronger policy will be possible if central agencies are created with responsibilities in this field.

So far it is mainly at the central banking "pole" of financial-monetary policy that some international centralization has come into existence. Historically, a tendency toward centralization appeared first in what Professor François Perroux has called the "dominant countries." For a long time the United Kingdom, as the richest and most powerful country in the world and a very important capital exporter, acted as the world's banking center. Later this task was partly taken over by the United States. After World War II the International Monetary Fund started operation. It has some

resemblance to a world central bank, but is not really one. Perhaps we may say that it is a central bank in its early stage of lender of last resort.

The present international monetary system, if we may call it that, was not based on a deliberate attempt to create an optimum system; rather it was the outcome of contact between national systems. With regard to the other "pole" of the world's financial-monetary order – the one handling the more efficient policy instruments – centralization hardly exists at all.

Again we must press for the application of the principles used inside our own countries to a wider area and the establishment of the necessary bi-polar set of institutions: a world treasury and a world central bank. It is only through such agencies that an efficient financial and monetary policy can be carried out. As an example we may consider the situation where a major country follows an inflationary or deflationary policy which harms the rest of the world. Consultation alone is not an effective method for correcting the situation. A world treasury would be able to give substance to a corrective policy by its own financial activity. A world central bank could give support by its credit policy. A central government has the means to correct an ill-advised gesture by provincial or local authorities; if our recommendations are carried out, similar means would exist in the international field.

In the monetary sector, it should be possible to build a system which would supply the international economy with the best quantity and quality of money and help to prevent crises of confidence. The systems demonstrated to be the most appropriate could be applied. But it should no longer be the dominant country system, with its inherent threat to confidence.

The case for a world budget was made in sections 6.2 and 6.3, in the context of development policies. From early remarks in the present section, it should be apparent that such a budget could also be used for anticyclical purposes. One possibility consists in the operation of the insurance scheme discussed in section 4.5. It is conceivable that gradually other tasks might be added. The world

budget may be put partly in the hands of IDA or OECD, but it should be, at least in part, a true world budget, handled by the United Nations.

9.3 LIQUIDITY PROBLEMS AND KEY CURRENCIES

As already briefly stated, monetary policies have grown out of national preoccupations, and have hardly been considered the task of a world agency. They have dealt more with the question of the qualitative conditions for sound money than with the question of a sufficient supply of the means of payment. Not that this latter problem has been unrecognized by experts; measures have indeed been taken, but in an incidental way. By chance, the ratio of gold to money has been decreased, as it should have been. We have mentioned the development of bank deposits as a means of extending the coverage of gold. Another measure taken by a number of the smaller countries was to use certain key currencies — sterling or dollars mostly, and other currencies in certain political areas — as substitutes for gold in the so-called "gold exchange standard."

In a recent book Professor Robert Triffin exposed the dangers of this key-currency system.[1] He showed that liquidities are not created systematically and for their own sake; they develop as a by-product of decisions of a completely different character. Thus in the last few years reserves of Western European countries have increased substantially because of (i) gold payments by the USSR, depending to a considerable extent on political decisions, and (ii) current deficits in the American balance of payments, considered an evil in themselves. Under the key-currency system, the danger exists — and by no means only in theory — that a key country will so mismanage its over-all financial policies that its currency will weaken and suddenly become the object of speculation. This makes for unrest, movements of "hot capital," and shifts from one currency to another, rather than confidence in the money supply. If the balance of payments position of the key country then improves, as a con-

1. See R. Triffin, *Gold and the Dollar Crisis — Future of Convertibility,* Yale University Press, New Haven, 1960.

sequence of, say, a stronger anti-inflationary policy, the outside world may be confronted by a liquidity crisis.

Professor Triffin has proposed another system which may be viewed as an application of sound national monetary ideas to the international community. His idea is to add another "level" to the monetary system, in the form of a truly international central bank. In principle, this bank would hold the world's gold stock — or most of it — and issue world paper money which would constitute the material for national central bank reserves. The central banks would base their notes and bankers' deposits on this world paper money — rather than on sterling, dollar, or gold holdings — and the private banks would cover their private deposits with the balances they maintain at the central banks. In all there would be three levels. Actually Professor Triffin later suggested a fourth level, to be created by inserting a continental central bank between the world central bank and the national central banks.

His system avoids the dangers of instability characteristic of the key-currency system. It also opens up new possibilities for conserving gold, and in a way therefore contributes to the problem of a future lack of liquidity. However, it is no better than the preceding system, as long as it would prescribe fixed reserve ratios throughout the banking community. The problem of having the correct liquidity volume cannot be solved if fixed reserve ratios are used. The idea of flexible reserve ratios, already accepted for short-term anticyclical policies, needs to be applied to long-term policies.

Two main problems must be considered in choosing between Professor Triffin's proposal and some other, less radical proposals to be mentioned below.[2]

One of them can be called the problem of management. Most central bankers today are afraid to accept Professor Triffin's ideas since they see implied in them a shift in management from the national central banks to the world central bank, presumably the International Monetary Fund. They seem to fear that the Fund, under pressure from the less developed member governments, would

2. See also *The Economist,* May 6, 1961, pp. 528–530, for a brief discussion of several proposals.

yield to more inflationary policies than are at present being pursued by the world at large. This fear is not shared by Mr. Edward M. Bernstein, who proposes that the present quotas of the member countries be integrated with their working reserves so that they can be freely drawn upon. Mr. Bernstein proposes further that creditor countries be asked to lend additional amounts to IMF.

Mr. Bernstein's proposal would solve the liquidity problem but it would leave the key-currency system intact. In his opinion this system is intimately connected with the role the United States and the United Kingdom play as international bankers and he places a high value on this role.

The other problem involved is one of transition. On the basis of the figures applying to today's situation, Mr. Bernstein fears that the shifts involved in switching from the present system to Triffin's would have a deflationary effect. But this problem of transition — with several others — can be a point for separate negotiation.

It is obvious that the change-over from national reserves to deposits with IMF should only occur gradually. It has been suggested that each country's initial IMF deposit be equal to at least 20 per cent of its central bank reserves. These deposits would enable the Fund to begin creating international credit, just as, on the national level, increased deposits enable banks to expand their operations. In order to avoid inflationary developments, Professor Triffin proposes that a ceiling be put on the annual increase in IMF's net lending in such a way that total world reserves would not be augmented by more than, say, 3 per cent a year. A smooth transition also requires that changes in the nature of the investments taken over by the Fund from the central banks be made very gradually, not surpassing, say, 5 per cent of these assets annually.

To some, Triffin's proposals appear too complicated. A shortcut method of increasing world liquidity has been proposed by Mr. Maxwell Stamp. Mr. Stamp suggests that IMF be authorized to issue Fund certificates up to a certain amount, say $3 billion for the first year. These certificates would be distributed among the newly developing countries, which could use them as an international means of payment of equal standing with gold or a key currency; a developed country willing to accept these certificates could use

them as part of its reserves, or sell them to other countries. A drawback of this system is that it would not solve the basic problem of the ambivalent role played by key currencies like the dollar and the pound.

Many other plans have recently been developed in this field, notably those of R. F. Harrod, M. Heilperin, A. Lamfalussy, J. Rueff, and X. Zolotas. A proposal to be mentioned explicitly is that of Professor James Meade.[3] Meade's ideas are similar to Triffin's, except that Meade proposes to transfer both the monetary gold stocks and the key-currency reserves to IMF so that national reserves would consist wholly of certificates issued by the Fund. Also, Meade wants to introduce a system of fluctuating exchange rates with IMF acting as an international equalization agency, whereas Triffin's plan calls for fixed exchange rates.

It is our conviction that the world's financial and monetary system would be better served by the Triffin system than by the simpler proposals. This does not mean that the simple proposals are not useful and would not work. In the end, however, something more would have to be done. Triffin's proposal fits very well into what we feel is a natural progression: to introduce a world policy and to apply internationally the principles tried out in the most advanced countries.

Professor Meade's proposal to introduce floating exchange rates would not be accepted by today's central bank managers. They intuitively feel that fixed rates would make a greater contribution to economic stability than fluctuating rates. The heart of the question is not always set out clearly or explicitly; it is whether adjustments with fixed rates are preferable to adjustments with flexible exchange rates. The most important adjustments possible within a system of fixed exchange rates are those concerning wage rates. Adjustments in items such as credit terms affect the economy in only a very superficial way.[4] Adjustments in wage rates without adjustments in exchange rates are not very satisfactory, however — an

3. J. E. Meade, "The Future of International Trade and Payments," *The Three Banks Review,* June 1961.

4. See J. Tinbergen, *Economic Policy: Principles and Design,* North-Holland Publishing Company, Amsterdam, 1956, especially pp. 113 and 114.

argument which appears to support Professor Meade's view. It is to be hoped that future discussions will bear more explicitly on this crucial aspect of the problem, and that in the end Meade's proposal will become acceptable to central bank managers.

9.4 WORLD STABILITY, NATIONAL STABILITY, OR COMMODITY STABILITY?

In this section we will take up once more the question of price stability, the importance of which has already been stressed (sections 1.6, 4.2 to 4.5, and 6.1). We do so because some of the instruments proposed as alternatives to price stabilization schemes for individual commodities are instruments of either financial or monetary policy. In fact, the choice before us may be formulated as in the title of this section.

Theoretically, the simplest scheme proposed is the commodity standard (see section 4.5). This constitutes a special type of central banking regime, in which not only gold but also a package of raw materials would be accepted as cover. The anticipated effect would be the stabilization of one thing only, namely the weighted price index of the commodities included in the package. This means that the average world price index would probably be stabilized too. The components of such an index, however, would not be stabilized.

The next simplest proposal is the scheme to insure countries against reductions in their export receipts (see section 4.5). As noted earlier, this is mainly a financial scheme, comparable to schemes of unemployment insurance, implying a system of money flows which will tend to stabilize the foreign exchange receipts of individual countries. The number of possible effects is much larger than in the case of the commodity standard. Stabilization of an element of income will help, in all probability, to stabilize total demand inside each country. Again, this scheme does not promise to stabilize the prices of individual primary commodities; the factors making for variations on the supply side will not disappear, though their effects will be weakened because the economic situation of the

producing countries will be less strongly dependent upon market conditions. The scheme under discussion is relatively simple and is confined to the relations between the insuring institution and member governments.

The third alternative is to increase the number of commodity agreements. The effect would be to more or less stabilize prices, and probably quantities sold. We might also hope that the incomes of a large number of producers would become more stable. Countries whose products were in large part covered by the scheme would also be less prone to fluctuations. Against this more refined set of results must be set the more cumbersome set of activities required to negotiate and supervise the schemes. In addition, we may ask to what extent natural equilibrating forces would be unnecessarily ruled out. The answer to this question has to be that free-market forces have not proved very helpful in restoring and maintaining equilibrium in these markets, and that there are a number of irremovable disequilibrating factors, such as crop variations and long production lags.

Of the two general schemes mentioned — the commodity standard and the scheme to insure against export declines — we consider the second preferable. It does not require the acceptance of any new monetary techniques, as the first system does — if only by some large central banks — and it can stabilize the economies of member countries. It represents another example of the application to world affairs of a principle that has shown its usefulness inside the developed countries: the principle of unemployment insurance. Moreover, the scheme has a large degree of flexibility in that the percentage decline in export income which warrants compensation can be chosen freely and may even be gradually increased if no unfavorable effects are experienced.

In addition, there are good reasons to conclude more commodity agreements. Most important is the fact that in some cases free competition does not have the generally favorable effects it is claimed to have. This applies to products with a long production period and low elasticities of demand and supply. Irrespective of other measures, such as the insurance scheme just discussed, there is al-

ways room for regulations where markets are inherently unstable. In our opinion, serious efforts should be made to extend the number of commodity agreements, and to improve their functioning.

With regard to the International *Wheat* Agreement, we note that too small a part of world wheat trade comes under the terms of the agreement, and that too much bilateral trade persists. We think it is gratifying that the USSR has recently shown its readiness to join the agreement. Finally, we point out that the International Wheat Agreement is suffering from a disturbed price structure because of government interference in wheat-producing countries. The chief offenders are the United States and Canada, the main exporters. These countries give support to domestic agricultural producers, a move which weakens the export position of the commodity. They also handle their marketing problems in such a way that world prices are constantly between the limits set by the agreement. This means that they are in a position to force relatively high prices upon importing countries with a lower standard of living. This seems contrary to the general principle applied in international integration treaties, namely that national regulations should — gradually — be adapted to international regulations and not international regulations adapted to one or more national schemes. We suggest that a transition period be agreed upon during which agricultural policies would have to be harmonized.

The same applies to *cotton*. As we have seen, the United States is by far the largest cotton-exporting country, and by its domestic support policy it imposes relatively high prices on the importing countries. United States agricultural policy has so far been one of the main obstacles to an international cotton agreement. Nevertheless, we think that, as with wheat, an agreement providing for the adaptation of national policies should be strongly promoted.

One of the characteristics of the International *Sugar* Agreement is that its "free market" sector covers less than half the world sugar market, the preferential blocs being subject to special regulations. In view of the increasing disequilibrium between world sugar production and consumption, the agreement's structure should be strengthened by simplification; in other words, the preferential

blocs should be included in the agreement's "free market" sector and made subject to its rules.

The International *Tin* Agreement has so far been successful. Although granting that the agreement, based on the buffer stock principle, is workable, we think it would function more efficiently if the United States and Germany joined (see page 79).

With regard to *nonferrous metals* we conclude that international commodity agreements are desirable. As production and consumption of the various nonferrous metals are often closely related, it has been suggested that these products be combined in a single commodity agreement, in order "to avoid some of the negotiations and economic disadvantages involved in tackling only one product at a time."[5] We fully endorse this suggestion.

The International *Coffee* Agreement is at present only a short-term agreement, and a long-term agreement is needed. To cope with present and future market problems, consuming as well as producing countries must be included. The same applies to *cocoa.* Insufficient attention has been given to the problem of long-term market stability. For both commodities, long-term agreements have been drafted and are being studied by interested governments.

In our opinion the discontinuation in 1954 of the International *Tea* Agreement was regrettable. Although the international tea market has since been stable, market conditions may change. Insiders admit that re-establishment of the agreement may be desirable sooner or later. We are in favor of its revival in the near future.

It is generally felt that international co-ordination is needed with regard to *bananas, citrus fruit,* and *olive oil.* So far a study of an international price stabilization scheme has been started only for the olive oil trade. We would strongly recommend the introduction of such schemes for each of these commodities.

5. See *Trends in International Trade,* Report by a Panel of Experts, General Agreement on Tariffs and Trade, Geneva, 1958, pp. 78–79.

CHAPTER 10

CONCLUSIONS AND RECOMMENDATIONS

10.1 TODAY'S CHALLENGES

In this concluding chapter an attempt will be made to summarize, in simple language, the ideas guiding this study and the suggestions for action resulting from them. In today's world we are faced with three great challenges. The first and greatest is the threat of nuclear war. The second is the misery in developing countries. The third one is the challenge of the Communist political and economic system. These three challenges are interconnected. The war threat is directly linked with the contrast between Communist and non-Communist systems. The Communist challenge, itself a result of the marked inequalities which existed in 19th century European societies, is considerably strengthened by the persistent inequalities in the low-income continents. The possible solutions to these challenging problems are also intimately linked. West and East

are competing doctors for the world's misery lands. A stronger West is one possible contribution to peace, but an even greater one is solidarity with the low-income countries.

This study deals mainly with the economic aspects of the world problems mentioned, but since the political and social aspects cannot be neglected, a few remarks going beyond the economic realm will be included in the final pages of this chapter (sections 10.8 through 10.11).

10.2 UNDOCTRINAIRE APPROACH NEEDED

In the present serious circumstances, when a maximum effort must be made, doctrinaire paths must be avoided at all costs. They are not compatible with an open-minded approach to world problems, and they imply a loss of effectiveness. In our opinion the West has been doctrinaire in two ways: with regard to economic systems and with regard to national autonomy. Even so, economists have shed light on both issues.

Neither of the *economic systems* defended today by doctrinaire extremists is particularly effective in creating well-being and development. A pure free-enterprise economy is not optimum; neither is a completely regimented economy. *Mixed* systems are better; the nature of the mixture depends on circumstances and must be the subject of careful engineering.

Autonomous national policy-making is not necessarily the best way to guide the affairs of the international economic community. More centralization is needed with regard to some instruments of economic policy. Either the use of these instruments could be coordinated at the international level or, better still, the instruments themselves could be handled by *supranational agencies.* The main reason is that these instruments will not be used with maximum efficiency if decisions are taken at the national level.

Careful research in the last ten to thirty years has pinpointed the *optimum instruments* of economic policy (discussed in Chapters 5 through 9), and indicated the *degree of centralization,* i.e., the level of governmental authority — local, state, continental, or world —

necessary for their optimum use. In the light of this knowledge it can be stated, among other things, that excessive national autonomy in economic policy aggravated the great depression; that the increasing role played by the federal government in the United States is fully justified; and that several functions of national governments may have to be partly transferred to a "higher level."

10.3 EFFICIENCY AND SOLIDARITY

Mixed social systems as they now exist in most countries function on the basis of efficiency and solidarity. These principles must not be confined to national units; they must be applied to the international economic order. As applied to economic policy *efficiency* means that an effort is made to determine the best means of reaching clearly defined goals; an efficient policy requires systematic planning, partly at a world level.

Solidarity means an element of common responsibility, and a regard for the well-being of groups, as contrasted to individual members. "Team spirit" is a typical expression of this notion; "the strong for the weak" is another expression of it. Social insurance and progressive taxes are instruments for its realization. So far, however, they have not generally been applied beyond national frontiers.

More intensive international co-ordination or integration may be said to mean the *application of our own principles* — i.e., those applied at home — *to the world at large,* or at least to the world of non-Communist countries. Only a timid beginning has so far been made. The spirit of the *Marshall Plan* is what is needed; and other countries along with the United States should display this spirit.

10.4 LACUNAE IN OUR INTERNATIONAL MACHINERY

Present-day agencies handling international economic policy must be judged against the background of the optimal system just indicated. Many of the instruments needed are already in existence,

but there are some clear lacunae. The most conspicuous are those in financial policy, in the realm of stabilizing the revenues of countries producing primary commodities, and in the field of insurance against noneconomic investment risks.

There is a need, first of all, for *centralized expenditure for development purposes.* The present level of such expenditure, international and national together, is insufficient, perhaps half of what it should be; and its geographic distribution is unsatisfactory. Existing national and international institutions are not able to correct these two defects; a larger portion of this expenditure must be guided by an agency with wider-than-national responsibilities. There must be an *international financial authority* of considerable strength, and it seems natural that this authority should be able to make *current expenditures* as well as provide loans, just as any central government makes a considerable portion of its development expenditure on a current basis.

The authority would have to finance its expenditures through *current contributions* from member countries. Apart from its role in development, its existence would strengthen considerably the influence that can be exerted on the *business cycle* and induce a more co-operative attitude on the part of national governments: by its policy the authority could *create incentives* for intergovernmental co-operation.

Secondly, there is a need for more agencies to deal with the problem of stabilizing the revenues of countries producing primary commodities. This may be accomplished by the conclusion of more commodity agreements or by the introduction of an insurance scheme against declines in export revenues.

Thirdly, private foreign investment in developing countries may be substantially furthered by the establishment of an international insurance scheme against noneconomic risks (see Chapter 7).

10.5 IMPROPER USE OF EXISTING INSTITUTIONS

In other cases the necessary institutions exist, but are not being used in the best interest of the world community. Usually this is

so when the form of centralization is one of the weaker types. Thus it may be said that some *trade policies* do not comply with the rules set by GATT and formally accepted by numerous governments. *Unjustified quantitative restrictions* on Asian industrial products and *excessive protection of European agriculture* are important examples. Also, trade with Communist countries is unduly restricted.

In addition, the *technical methods* used to bring about a reduction of impediments on trade are inefficient, especially item-by-item negotiations.

There is need for a *regional approach* to the ideal of GATT; Europe's example might be followed in Asia and in Africa, where a beginning has been made by groups of neighboring countries. Latin America has made progress in this direction. At the same time, the European Economic Community should be careful to reduce the level of its agricultural protection and discrimination against nonassociated areas. In this study we have made detailed suggestions concerning the *import duties and consumption taxes* on a number of primary commodities (see Chapter 8).

Some of the principles of GATT require revision; thus certain tariffs should be considered legal only if applied temporarily (see Chapter 8).

Finally, international balances with IMF might well replace key currencies as the cover for national circulation (see Chapter 9).

10.6 AN OPTIMUM POLICY FOR THE NON-COMMUNIST WORLD

Since the Communist world cannot be directly influenced by Western countries, the responsibilities set out in the preceding sections charge us to organize the best conceivable policy for the non-Communist part of the world. Thus the financial authority recommended may be organized within *IDA,* or possibly *OECD* if it could extend its membership to developing countries. More *commodity agreements* must be concluded at least between the non-Communist countries. This is particularly important in the case of cocoa, some nonferrous metals, bananas, and cotton. The scheme to

provide insurance against export declines may also be organized among these countries.

Western European integration is the aim of a group of non-Communist countries, and attempts at closer co-operation are being made in the Arab region, Asia, and Africa. A number of *ad hoc* organizations such as the Colombo Plan and many forms of bilateral co-operation are serving a useful purpose at "lower levels"; this is all to the good, provided that the organs at the highest levels are sufficiently endowed with supplementary means to carry through a program of optimal intensity and optimal geographic distribution.

10.7 THE ROLE OF THE UNITED NATIONS

It would be a mistake, however, to confine ourselves to the non-Communist world. The ideas set out must be applied to the whole world. They must be used to give strength and perspective to the idea of a truly *international order,* that is, they must be used to strengthen the United Nations. The Charter of the United Nations is couched in general terms only. With our present knowledge of how international economic and social affairs can best be conducted, we can give more precise and more efficient content to the tasks of the United Nations. We can define the instruments and organs to be used, and in so doing we can give real meaning to the idea of "peaceful coexistence."

Some will point out that the Communist countries may not want to co-operate and may even try to frustrate such activities as may be entrusted to the United Nations family of agencies. Our answer is, first of all, that the aim of increasing world stability and peace is worth some risk; and secondly, that the risks seem to be small in the case of some of the tasks to be given to the United Nations.

We see three new sets of tasks for the United Nations in executing the policies advocated.

(i) The United Nations could formulate the *main aims* of world economic policy and prepare, at regular intervals, five- or ten-year forecasts of economic development. More precise suggestions are offered in Chapters 5 and 6. On the

basis of these studies, the *annual discussion* in the Economic and Social Council of the United Nations could be given more operative importance. Following the example of OEEC, *national policies* may be discussed with a view to convincing governments of the overriding importance of world aims. Depending on the preparation and organization of this discussion, ECOSOC might be more instrumental in creating an international order than it has been so far.

(ii) If more development funds were given to it, the United Nations could correct some of the undesirable features of today's geographic distribution of aid and private investment. The financial resources needed to accomplish such a *supplementary task* do not necessarily have to be concentrated at the United Nations: the better some "lower" organs, including those discussed in section 10.6, carry out their tasks, the smaller the sum needed at the center. But the funds available for this purpose must total considerably more than the amount now in the United Nations' hands.

(iii) Important tasks could be carried out by some of the *Regional Commissions* of the United Nations, both in the field of *planning and forecasting* and in the field of *regional co-operation and integration*. More precise suggestions will be found in Chapter 7. In a region where co-operation is in its first stages, the Regional Commission could be especially helpful in spreading objective information about the advantages to be obtained from regional co-operation and integration, and in taking steps to bring such co-operation about.

10.8 OTHER ASPECTS OF THE INTERNATIONAL ORDER

The contribution of the Western world to strengthening the international order cannot be solely an economic one. We have already noted the intimate links between the problems of *security, political organization,* and *economic policy*. To be sure, the economic contribution is the one which seems most promising, regardless of the

response from the Communist world. A stronger international economic order, along the lines indicated, would contribute to peace in several ways. It would remove some of the tensions existing today; it would also counter the Communist belief that the West is unable to survive. Yet the overriding problem of security cannot be solved by economic measures alone.

One disequilibrating aspect of today's world is the two-pole system of thought and action. It is comparable to the internal political structure in Germany around 1932, where the extremists at the right and the left were strong and the center grew weaker and weaker. (This is not to say that the ideologies involved then bear much relationship to the ideologies at stake in the world today.) There must always be a stable center if there is to be a stable world.

Because of the conflicting views and the mutual distrust existing between the Communist and the Western world, it will be necessary — in light of world interests — for the uncommitted countries to take over more and more tasks of crucial importance in the international field — not only tasks of an executive nature, like heading international agencies, but also tasks in the sphere of decision-taking. In other words, in future years it will be the voice or the vote of the uncommitted countries that will tell the world what to do when the opposed blocs of East (used here to designate the Communist countries) and West cannot agree on a policy. If such an arrangement or constellation is to operate effectively, the uncommitted countries must of course be truly uncommitted — in the fullest sense of the word — to either bloc, and in addition they must be capable of developing clear policies.

For this reason, it seems to be in the interest of world peace that the uncommitted countries remain or become as independent of both East and West as it is conceivable for them to be. This, however, would require a reorientation of the international policy of the two blocs. The Western countries would have to abandon policies designed to "induce" the developing countries to choose to join the West's ranks, and adopt instead policies based on the assumption that the developing world will follow an independent path.

It might be argued that such a turnabout would be unwise because the Communist part of the world is not likely to follow suit,

and with the lack of counteracting Western forces, Communist attempts to make friends among the newly developing countries would be more successful than at present. The answer to this is that many — if not all — countries not directly associated with either West or East are eager to retain, and even reinforce, their uncommitted status. If one of the two blocs competing for their friendship and favors withdraws voluntarily for the sake of strengthening the independent position of the developing countries, it is very likely that the other bloc's overtures will be rejected. Many developing countries that now have rather close ties with the Communist bloc have established these relations for fear of Western dominance of their international contacts.

10.9 SOME SUGGESTIONS ON SECURITY

The political considerations just discussed may even be of some relevance to the most important problem of today, which is without doubt that of security. In the final analysis this problem may be said to be one of devising institutions and procedures which will help to achieve and maintain a stable equilibrium of forces. That the lack of trust between the two major powers is a major obstacle to the establishment of such institutions and procedures goes without saying. Any suggestion must take this distrust into account. An equilibrium of forces might be said to exist at present, but if so, it is far from stable. The elaborate studies made by Schelling and Halperin[1] show the multitudinous aspects of the equilibrium, and the many different unstable and stable movements which may occur depending on the random disturbance that starts them. Their analysis is bewildering because it shows how many unknown risks there are and because many people in responsible positions will probably never fully understand the mechanism.

Some comfort may perhaps be found in a remark made by Professor J. Goudriaan with regard to business cycle policy but applying equally well here: "We do not need to know the dynamics of the present unstable equilibrium just as an engineer does not need

1. Thomas C. Schelling and Morton H. Halperin, *Strategy and Arms Control,* Twentieth Century Fund, New York, 1961.

to know the dynamics of a collapsing bridge. What we need to know is the statics of a stable equilibrium, just as the engineer must know the statics of a bridge that will not collapse." Let us therefore look for a stable equilibrium, or at least for a more stable one.

The well-known solution, which is stable indeed, is the establishment of a world government with a world armed force while all national governments are disarmed. This solution has been on the minds of all those interested in world security; it was the idea at the basis of the creation of the League of Nations and the United Nations, and it still is the idea basic to world federalism. It demonstrates at the same time the interdependence of security, political, and socio-economic conditions which we reminded the reader of in section 10.2. World government presupposes the acceptance of a duly elected authority by all concerned.

That a satisfactory voting system can at the moment be devised is highly doubtful. We must explore that side of the problem nevertheless, and some suggestions will be made in section 10.10. In this section we will discuss what the position is in the absence of a common voting system. The machinery for a stable solution does not presently exist. Are there power configurations with a higher degree of stability than the present system of two more or less equal power centers?

The reason why neither West nor East is willing at the moment to accept a world force is simply the fear that in the event of conflict between them the world force might side with the other party. To mitigate this risk a system might be tried whereby both camps would be only partly disarmed; as one possible example we can imagine a situation with three forces of, say, comparable strength. Such a system would indeed be stabler than the two-pole system in a number of circumstances. This would be true in cases where an aggressor could be defined, assuming that the world force would take the other side. It would also be true in a class of cases where criteria could be devised to determine the legitimacy of one or the other stand and the world force would back the legal side. There might be other cases where stability would not be increased.

The risk characteristic of the one-force case would remain, but on a smaller scale. The action of the world force would again have

to depend upon a voting system and the outcome of the vote might be unacceptable to one of the parties. But this risk would now apply to only one-third of the total force. One can also imagine an extremely controversial case where the unity of action of the world force was broken; this would bring us back to the present situation of two poles.

The process of exploration can be taken one step further. If the main risk involved in the three-power configuration is that the world force might choose the "wrong" side — whatever that might mean and whatever motivation might be involved — we can think of a four-power system, the fourth power being a neutralist force, one organized by the "South," the uncommitted countries. To be sure, the uncommitted countries are militarily weak at present, but they need not remain so. If co-operation between groups of developing countries in the economic, social, and political field should indeed develop further, it might lead to area-wide co-operation in the security field also; and collaboration of these "area defense systems" could facilitate the organization of a Southern force. The merit of such a four-power system is that if the world power chose the "wrong" side, there would be a tendency for the Southern force to choose the opposite side.

These schemes are suggestions only. They are presented here for two reasons. They are intended as examples of a static analysis of security systems which seem to us to make sense even if they are much simpler than the dynamic analysis favored by some other authors. And they are intended as examples of the sort of specifications one might hope to obtain from more highly qualified experts on both sides of the iron curtain.

10.10 REVISION OF VOTING SYSTEMS

Another issue to be resolved by anyone speaking about coexistence or about revision of the United Nations Charter concerns, as we observed earlier, voting rights in the United Nations. These rights become the more important the larger are the tasks entrusted to the United Nations. As we said in section 6.4, we attach signifi-

cance to efforts to construct a better international order despite the risk that the Communist countries may, from the West's viewpoint, abuse them. Such efforts are important not only for their own sake but also for the sake of clarifying our intentions, including our willingness to do positive work with the Communist countries.

There are two main difficulties with the present voting system of the United Nations. First, it gives to a number of member countries an influence which, by all democratic standards, is not in conformity with their importance. Secondly, it does not sufficiently reflect the contrast which at present divides the world.

Less than proportional representation is found in many representative bodies, e.g., the legislative branches in many countries. It is essentially undemocratic for India to have the same influence on a United Nations decision as the Netherlands. Considerable weight must be given to country size, in terms of either population or contribution to UN activities. The latter way of measuring a country's role is an old democratic principle; it is realistic in that it is indicative of the economic effort a country is making. It has, however, a less attractive side in that it discriminates between the rich and the poor. It might be possible to compromise by giving equal weight to numbers and to contributions to UN work. This procedure would also facilitate the solution of a possible future problem: how many representatives should be apportioned to a new country that emerges through the integration of a group of former members?

The second issue should be dealt with along the lines followed repeatedly nowadays in social matters in democratic countries. Even democratic countries do not always have democratic institutions for all their important economic decisions. In business, decisions are often taken autocratically by management, with no influence from the workers. Some types of decisions have been democratized, however, and the principle applied is to give an equal number of votes to each "class" involved, e.g., to employers and employees. Sometimes three groups are distinguished and given equal influence, the third being either representatives of all other social groups or government representatives or experts appointed because of their personal knowledge of the subject. The latter principle,

somewhat modified, was applied in the organization of the oldest international agency, that is, in the composition of the General Conference and the Governing Body of the International Labor Organization. Each national delegation is composed of one delegate representing management, one representing labor, and two government delegates. Various applications of these techniques would seem possible with regard to the question of voting rights in special United Nations bodies. One might be to give equal numbers of votes to the "West," the "East," and the "South." Another possibility — not necessarily combined with the foregoing — is to give voting rights to experts in the United Nations. These experts have played their part on several occasions in the past.

Again our remarks are meant mainly to suggest that explicit studies should be made and published so as to give more precise content to coexistence possibilities as viewed from both camps.

10.11 DEFINITION OF LEGAL SOCIAL CHANGE

A new international order must also be explicit about economic and social matters. If an armed force of some size is available to the international government, there must be rules and procedures for its use; certainly it cannot be used in cases where changes are brought about legally. Legal changes may include all internal revolutions, or they may include only some types. The broader concept seems to be implied in the present United Nations Charter, except in cases where international peace is endangered by the situation within the country. Other specifications may be desirable, but agreement must first be reached as to what social changes are acceptable. Agreement does not seem to be impossible with regard to changes such as the elimination of feudal and colonial regimes or the nationalization of industrial enterprises, provided satisfactory compensation is offered.

This problem, and others mentioned in the last four sections of this chapter, may be said to reflect the full difficulties of the present conflict between Communist and non-Communist ideas. The importance of these problems is such that unprecedented efforts must

be made to solve them. It is amazing, and highly unsatisfactory, that so relatively small a part of the vast intellectual resources now directed at solving scientific problems is being devoted to the problems touched on in the preceding pages. A modest beginning has recently been made by some institutions.[2] The few groups that are operating in this field urgently need our attention and firm support.

2. See Schelling and Halperin, *op. cit.*, and D. H. Frisch (ed.), *Arms Reduction: Program and Issues*, Twentieth Century Fund, New York, 1961.