CHAPTER 1

NEW COUNTRIES AND OLD PROBLEMS

1.1 INTRODUCING THE BOOK

The world is in the process of a great transformation. In a considerable part of it a new economic order, "communism," is being vigorously tried out. Elsewhere an old order is passing as one country after another throws off the yoke of colonialism. The wholesale introduction of Western techniques and ways of life is shaking the foundations of numerous beliefs and attitudes, for good or for evil. A spurt of population growth accompanies this development. All of these changes, with their multiple potentialities for conflict, are taking place in an era in which mankind has just discovered the possibilities of nuclear warfare.

The Western countries, not so long ago the masters of the world, have been deposed by the very forces they liberated. This drastic change is not yet fully understood by the Western nations themselves.

The world, characterized by a vast gap between technical ability and moral power, is in desperate need of a policy — a policy which will give it shape, and create a framework for the solution of its urgent problems.

This book is an attempt to analyze that need and to make constructive suggestions for means to satisfy it. It is a book written by Westerners, possibly with many Western biases. Nevertheless the author and his associates have tried to free themselves as much as possible from bias and to apply in their analysis the objectivity of that scientific attitude to which the West, however much it may be open to criticism, has given rise. Thus they have tried their best to look at the world's problems from the standpoint of all concerned. In this they have had the advantage of consulting with many people representing other continents and other convictions than their own.

The book does not contain a great deal which is new. Apart from a few modest contributions to the quantitative analysis of some of the problems encountered, only the arrangement of the subject matter purports to be novel. The plan of the book is to discuss, in Part I, the tensions characteristic of our present world and, in Part II, policies which might ease the situation.

Part I consists of four chapters. The first begins with a brief description of the main tensions in international life, then concentrates on what is believed to be the most important economic problem — that of the development of economically backward countries. Chapter 2 describes the two competing economic systems — the Western and the Communist — which have succeeded in bringing about a measure of economic development in their own parts of the world, and discusses the essential features of each. At the same time, this chapter deals with some of the main instruments of development policy, especially those to be used by the developing countries themselves. The two remaining chapters deal with the international environment in which development has to take place and describe the setting with regard to trade and stabilization policies.

Part II represents an attempt to deal systematically with the problem of an optimum international policy, mainly but not wholly in the economic field. In Chapter 5, the basis of such a policy is discussed, i.e., the interests it must serve. Chapter 6 defines the aims, and discusses the most important means open to the policy-makers. Chapter 7 is devoted to the core of development policies — investment. Chapter 8 deals with the complicated matter of trade policy. Chapter 9 covers what is thought to be the clearest lacuna in our international economic order — the lack of an international financial authority. Finally, the last chapter summarizes the conclusions reached, and, going somewhat beyond the boundaries of economics, makes some suggestions regarding the wider problem of co-existence between Communist and non-Communist countries.

1.2 POLITICAL AND ECONOMIC STRUCTURE OF TODAY'S WORLD

This section tries to give a summary picture of the political units which comprise our world, indicating only their basic economic and political characteristics and their main groupings. No summary view could do justice to the complexities of the world's structure, but it is questionable whether a more detailed picture would serve our purpose better. Involved are over a hundred different countries, loosely arranged into various groups which are somewhat more homogenous than the world at large.

The first feature to be mentioned is the existence of a group of countries under the rule of Communist parties. The West usually speaks of them as the "Communist" countries or the "Communist bloc," whereas they prefer to speak of themselves as "socialist countries."[1] Western socialists feel that socialism should incorporate the element of political democracy in the Western sense, that is, that the population should exert an active influence on gov-

1. In the terminology of these countries, communism is a state in which the distribution of income is based on needs, whereas socialism is, in this respect, characterized by incomes based on productive contributions. Both systems are based on communal ownership of the most important means of production.

ernment. All countries outside the Communist group may be called non-Communist although they are very different, as will be set forth below. When using the breakdown just mentioned we will call Yugoslavia a Communist country, although it maintains less close relations with the other Communist countries than is typical of this group.

A second feature of today's world is the existence of already developed and developing countries, in both the Communist and the non-Communist sectors. The criterion here is mainly an economic one, although development in many other fields appears to be a related phenomenon. Of course, there is no sharp dividing line and one may wonder how to classify some countries, say Venezuela or Argentina. Roughly speaking, Asia, Africa, and Latin America, together with a number of countries or parts of countries in Southern Europe, are economically in the process of development. Although we are aware that it is a rather poor yardstick, the simplest criterion to apply is that of income per head. If income per head is above $250 a year, development may be said to be under way in the country concerned.

A third major feature of the political structure today is that colonialism is rapidly passing from the scene. To be sure, a number of countries in the non-Communist area are still under the rule of more developed countries, and a type of neocolonialism has come into being in the Communist area. Some very important former colonies, however, have changed their status and now have national independence. This is true of almost all of Asia and Africa.

Together with a number of developing countries which have been politically independent for a long period, the former colonies are to a considerable extent "uncommitted," i.e., not attached ideologically either to the Communist countries or to the developed Western nations. A country's ideological leaning is more difficult to determine than its development status or political system, and changes are more frequent. Leading countries of the uncommitted world are India, the United Arab Republic, and possibly Ghana; another important member of this group is Indonesia. Other countries may come to the forefront in the future. These countries maintain close ties with Yugoslavia, in a way also an uncommitted country. In some important Asian countries, like Japan and Pakistan, the close links with the West depend on the political preferences of a section of the community and may not persist. Most Latin American countries are in the process of transition and may increasingly feel uncommitted.

A final feature of our world, in the context of this section, is the tendency of some groups of countries toward integration, i.e., the giving up of some elements of their national sovereignty. This tendency is strongest in Western Europe, where close institutional links have already been established between the six countries of the European Economic Community (EEC, or the Common Market); discussions with the United Kingdom and other countries about their joining the Community are under way. The Community also has "associated countries," which include a number of African countries and Greece.

A start toward regional integration has been made in Central America and in Latin America generally, as well as in the Arab region. Still weaker tendencies can be observed in parts of Asia and Africa, but for understandable reasons most of the countries in these areas are not yet prepared to give up even small portions of their newly obtained sovereignty.

Today's most important tensions in the political and economic field have to do with the three main divisive factors indicated — communism, development, and colonialism. Of the problems involved some are economic while others are political and military, to mention only their most important aspects. The three main issues can hardly be separated and only a simultaneous solution will be satisfactory. Some problems, such as that of military security, seem almost insoluble in the situation which confronts us today. The problem of underdevelopment must have a central place in any attempt at "shaping the world." First of all, the problem concerns the basic human needs of large portions of the world population; secondly, its character is relatively clear and mainly economic — a field in which mankind has made enormous progress; and thirdly, its solution may help to ease the other problems. For an elaboration of this last point see especially Chapters 2 and 10.

The problem of underdevelopment is aggravated by economic instability, especially in primary markets, and the shortsightedness of national policy-makers in matters of foreign trade. In the following chapters this theme will be developed further.

1.3 AN INCREASING GAP

The most basic and alarming feature of the underdevelopment problem is the fact that in the non-Communist area the gap between the developed and the less developed countries is, generally speaking, increasing in terms of real income per head.

It has been increasing if we make comparisons over a relatively long period, say the last fifty years. It must be admitted that no very precise figures are available for the majority of the underdeveloped countries around 1900; we must be content with crude estimates, except possibly for India. However, this should not prevent us from trying to get at least an impression of what the situation has been. Probably the most comprehensive and systematic student of the subject has been Professor Louis J. Zimmerman.[2] His data show that over the last half century there has been little change in real income per head in most of Asia, traditionally the home of over half the world's population. We all know that, by contrast, real income per capita has risen considerably in the West, especially in the United States, Western Europe, and a few high-income countries elsewhere such as Canada, Australia, and the white portion of South Africa. The picture with regard to these extremes in incomes is clear enough.

Less certainty exists about more recent developments and about countries not at the extremes of the distribution. In the last decade some success has been obtained with deliberate policies to promote economic development. In Latin America, which occupies an intermediate position, income has probably risen in the last half century

2. L. J. Zimmerman, *Arme en rijke landen,* Albani, The Hague, 1960.

Table 1–1

TREND OF PER CAPITA NATIONAL INCOME IN MAJOR AREAS, 1913–1957
(figures in dollars of 1952–54, not corrected for differences in price levels between countries)

	1913	1929	1952–54	1957
North America (excl. Mexico)	$917	$1,243	$1,810	$1,868
Oceania	572	680	964	1,110
Northwestern Europe	454	528	681	790
Soviet Union (USSR)	162	178	535	750
Union of South Africa	177	221	300	318
Southeastern Europe	200	181	285	360
Latin America	170	196	260	300
Japan	85	152	184	240
Far East (excl. China and Japan)	93	106	109	115
Southeast Asia	65	68	64	67
China	50	50	50	61
		Index (1913=100)		
North America (excl. Mexico)	100	136	197	204
Oceania	100	119	169	194
Northwestern Europe	100	116	150	174
Soviet Union (USSR)	100	110	330	463
Union of South Africa	100	125	169	180
Southeastern Europe	100	91	143	180
Latin America	100	115	153	176
Japan	100	179	216	282
Far East (excl. China and Japan)	100	114	117	124
Southeast Asia	100	105	98	103
China	100	100	100	122

Source: L. J. Zimmerman, *Arme en rijke landen,* Albani, The Hague, 1960, pp. 29–31.

as well as lately. In addition, the recent economic development of the wealthiest among the big powers, the United States and the United Kingdom, has been relatively unimpressive. Recent movements are difficult to appraise because of the random variations occurring from year to year as a consequence of crop conditions, cyclical fluctuations, and so on. It is significant nevertheless that the rise in real income per head in such an important country as India has been, in the last decade, definitely less than the rise in real income per head in the countries of the European Economic Community (EEC). While the former may be estimated at 1.5 per cent per annum, the latter has been over 3 per cent.[3] When appraising these data we should not forget that even an equal rate of growth would widen the absolute gap.

Table 1–1 summarizes some relevant information.

To understand what these figures mean in simple human terms, we must realize that most of the people in Asia and Africa and many in Latin America are living at a starvation level. Their consumption is some 10 per cent of that in developed countries and they are in a constant fight against hunger and illness. Everything in their budget — food, clothing, housing, education, amusement — is far below adequate standards as we see them. For a long time these people have been forced by circumstances and encouraged by philosophies, partly geared to their situation, to accept their condition as natural. Increasing contact with the wealthier parts of the world is now raising a question in their minds as to the necessity for their underprivileged status, and it seems clear that once this doubt has worked its way through the population we shall witness justified attempts to change the situation — attempts which may be carried out with an energy corresponding to the tensions endured. It is because such basic human issues are involved for such a large number of people that this problem is so important. It deserves to be our main preoccupation. We will try to analyze its causes, and then, in Part II, discuss possible remedial action.

1.4 BASIC CAUSES OF POVERTY

In itself the phenomenon of extreme poverty is not new. The less developed countries have been poor for a considerable period. For a very long time this poverty was the natural lot of a large

3. For 1950–1959: Federal Republic of Germany, 6.2 per cent; Italy, 4.6 per cent; the Netherlands, 3.5 per cent; France, 3.1 per cent; Belgium, 2.1 per cent. (See *Maandschrift van het Centraal Bureau voor de Statistiek,* W. de Haan, Utrecht, 1961, p. 220.)

section of the world's population. Any attempt to analyze its origins should distinguish between direct and indirect causes, i.e., the phenomena logically linked with it which are closest and those which are more remote. The best analogy may be that of a chain; the indirect causes are represented by all the links except the last, which is the immediate cause. The chain is no one-way avenue of causation, but shows numerous interconnections: the links are interwoven. While we know something about the strength, and so about the relative importance, of the direct causes of poverty, our knowledge about the more remote causes is qualitative rather than quantitative, and still very modest. Broadly we may say that the direct causes are more of a technological and economic nature, whereas the indirect ones, those farther back in the causal chain, tend to be psychological, historical, or geographic rather than economic in the strict sense.

We may consider as the central phenomenon to be explained by our analysis the low level of production per human being. The most important direct causes may then be listed as follows:

(i) a low level of technical and organizing skill residing in the human factor of production; and

(ii) a small quantity of the complementary factors of production, i.e., the total of land and capital.

Each of these direct causes stands for a complex of phenomena, since each of the factors of production may take a variety of forms. Thus, human skills are many-sided, capital may take a large number of concrete shapes, and "land," in the sense used here, embraces a range of soil fertility, climate, and mineral wealth.

Broadly speaking, the quantity of land and capital at the disposal of the less developed countries is much smaller than in developed countries, in roughly the same proportion as their incomes are related. There are considerable differences in the relative importance of land and capital among underdeveloped countries; in some, land is relatively abundant but capital very scarce. However, for most of the population in the underdeveloped sections of the world land is very scarce too, India and China being familiar examples. Skills, particularly the more relevant ones, are seldom the subject of a census; nevertheless, indirect observations, such as the number of illiterates, clearly indicate a shortage in this area.

Both the skills and the capital available per head are linked logically with the indirect or deeper causes of the existing situation, and, in a general way, we may say that the latter are to be found in:

(i) the more basic attitudes of the peoples considered; and

(ii) a number of geographical and political facts, current and historical.

The basic attitudes relevant to economic development can be deduced from an analysis of the decisions or choices which human beings must take in order to establish or maintain a modern economy. Among these decisions, those concerning the use of durable means of production stand out. These only bear fruit in a more or less remote future about which there must always be some uncertainty, and they require co-operation between large numbers of individuals. The most important basic attitudes involved are:

(i) an interest in material well-being;

(ii) a willingness to look ahead;

(iii) a willingness to take risks;

(iv) an interest in technology;

(v) a willingness to co-operate;

(vi) an ability to persist;

(vii) a willingness to accept the "rules of the game."

Students of the subject have chosen various formulations; some have left out a few of the attitudes listed and added others. But by and large there is a consensus of opinion about the sort of attitudes needed. There is also a consensus of belief that these attitudes are not sufficiently widespread in underdeveloped countries. Thus, business men in these countries often prefer quick profits from speculation to long-term profits obtained more patiently from mass production at relatively modest profit margins. Corruption often puts a brake on development. In a way, the population problem — which is rapidly becoming very pressing — may also be said to be due to a lack of willingness to look ahead, sometimes along with a lack of understanding of the operation of the economy.

The attitudes mentioned are not independent, however, of the environment in which a population lives. They reflect the economic situation itself and are interdependent with it. Willingness to look ahead is slight with people living on the margin of subsistence, as can easily be understood. So also is the ability to persist. Corruption is partly a consequence of huge income differences.

The attitudes discussed also depend on more remote factors in the environment: geographic and political factors thus come in. These may have been at work for a long period. Surely the tropical or subtropical climates in which almost all the less developed countries are situated are not conducive to persistence or to productivity generally. The geographic environment may have deteriorated because of the exhaustion of natural resources: erosion may be cited as a specific example. Or it may have deteriorated because of a change in trade channels and traffic currents. The natural endowments of a people may be less favorable than those of other peoples. To be sure, our knowledge in this respect is very incomplete, but in a majority of the cases where variations in basic attitudes can be observed, it is probable that these variations can be explained by differences in the economic position of the individuals involved or their parents or even grandparents (see section 1.5). It is also conceivable that migration has systematically exerted a counterselective influence on a population. In a region where the economic situation was worsened by the factors just mentioned — e.g., exhaustion of natural resources or change in trade channels, phenomena which have appeared repeatedly in history — emigration often took place. Presumably the individuals who moved were more interested in material well-being and more willing to take risks than those who stayed behind. The remaining population was then, on the average, less gifted with the prerequisites of economic development. Thus emigration may have intensified the process of decay in the economy concerned.

Among the political factors which may have played a part, either recently or in the past, colonial rule may be mentioned. Such a political situation may suppress, or at least insufficiently cultivate, the forces making for development. This can happen when economic development is kept in the hands of foreigners and the fruits of development – or of exploitation – are taken by a ruling nation. There are other possibilities too, some of which will be discussed below (in section 2.1). We may provisionally state that the effect of colonial rule depends on its character; the results may have been negative as well as positive. A broad comparison among countries within the same region does not seem to show that those which have been independent are better off than those which have been colonies. Consider, for example, Thailand compared with Malaya, Burma, and Indonesia; Ethiopia and Liberia compared with Kenya or Nigeria.

1.5 VICIOUS CIRCLES

The persistence of poverty in the less developed countries, and the difficulties involved in reaching a stage of self-sustained growth, must be attributed partly to the functioning of the socio-economic system itself. An easy way to visualize this operation is to use the term "vicious circles." Certain mechanisms tend to keep a system at the low level where it has been for inherent reasons or because of outside events, e.g., a deteriorated geographic position or some political development.

One example is the interdependence of income and capital: a low capital stock implies a low level of production, and so of income. But a low income does not permit large savings, and hence the capital stock cannot easily be increased.

A second example is the interdependence of income and health. Low incomes depress the level of nutrition and do not permit sufficient medical services to maintain good health. Ill health in turn depresses personal efforts in production and may keep down productivity.

A third example refers to the interdependence of income and education. Low incomes do not permit extensive educational facilities, and with inadequate education skill and productivity will tend to remain low.

Looked at in the reverse way these relations tell us that considerable effort will be needed to break these vicious circles. We will discuss this effort in section 1.7.

1.6 THE FATE OF PRIMARY MARKETS

It is in the nature of less developed countries that they are mainly producers of primary goods, i.e., agricultural or mining products. With a low level of human skill and capital, the types of production in which they will have a comparative advantage will usually be those dependent on natural resources. Not only the "supply side" but also the demand side is geared this way, for the poorer nations' greatest need is for food. To finance their imports underdeveloped countries will have to export primary commodities. The markets for such goods are often not such as to stimulate their development. There are of course some exceptions, of which petroleum is the best known: its production and export have, though not without foreign investments, led to rapid improvement in the economic position of a number of countries. Several other examples could be mentioned.

The majority of primary product markets, however, have two important drawbacks. First of all, their secular development is usually slow. The demand for basic commodities grows only slowly with increasing income, or, as the economist puts it, the "income elasticity of demand" is low. In addition, sellers of some important natural raw materials have experienced competition from substitutes such as rayon and other synthetic fibers, and artificial rubber.[4] The second drawback is the short-term instability of prices. The output of many primary goods is dependent on crop yields which vary erratically and widely. Also, market prices are in a sense a residual, and fluctuations in demand, mostly of a cyclical nature, will lead to much greater fluctuations in prices of raw materials than in prices of finished products. In addition, several primary products such as coffee and rubber show price cycles of a special

4. See *Trends in International Trade,* Report by a Panel of Experts, General Agreement on Tariffs and Trade, Geneva, 1958, especially pp. 43–44.

character due to the long period of production of existing trees and the time required for growing new trees.

Partly as a consequence of the slow pace of expansion of primary markets, and partly because of the efforts needed to shift productive factors to other occupations, the relative prices of primary goods (or their terms of trade) vis-à-vis those of industrial products are deteriorating. There have indeed been periods of improvement, as, for example, during and after World War II, but the prospects for the next decade are not too favorable unless action is taken.[5]

1.7 THE NEED FOR A BIG PUSH

We have already expressed our belief that the increasing gap in well-being between the developed and the less developed countries is one of the most important problems of today's world. We will pursue this line of thought more fully in Part II. In the present part of our analysis we merely want to set out in brief what is needed in order to improve the situation of the less fortunate nations.

From the preceding sketch it is clear that a deliberate effort will have to be made: it is improbable that an accelerated rate of development will come about spontaneously. In order to increase production in underdeveloped countries substantially, the quality and quantity of the factors of production — skills, attitudes, and the quantity of capital goods in all forms — will have to be increased. From our earlier analysis we can understand that it is very difficult for the economies and societies concerned to make this effort. The forces operating in the vicious circles described have a tendency to maintain the *status quo*. Only a considerable increase in each of the factors mentioned can produce a great enough response in national income to bring about the additional savings and educational facilities needed to sustain the process of growth. Small increases in product may prove ineffective if the random movements

5. See M. K. Atallah, *The Long-Term Movement of the Terms of Trade between Agricultural and Industrial Products*, Netherlands Economic Institute, Rotterdam, 1958, p. 74.

discussed previously happen to be adverse. For the process of growth to be self-sustaining, to use the customary term, there must be confidence that no setbacks will occur. This can only be the case if the trend of annual increases in production – the momentum – is sufficiently high to offset the effects of negative random movements.

The desirability of a considerable increase in production, and hence in the factors of production, is often referred to as the need for a "big push."[6] There are further reasons why a big push is desirable. These are to be found in the peculiarities of some of the capital goods needed in the process. If an economy is to diversify its production and introduce some types of manufacturing industries, there is a need for a so-called "infrastructure" of investments. This term refers to investments in the basic industries, especially energy and transportation, whose services are used by almost every other industry. Other investments are often included, such as outlays for schools and dwellings. Their common characteristic is that they do not usually yield quick and visible profits to their operators, either because very long processes of production are involved or because the end products cannot easily be sold. This characteristic holds especially for the product of roads but applies also in the case of education. These conditions suggest that the infrastructure is best taken care of by public authorities. Although this dictum does not necessarily apply to energy, the feature now to be discussed often makes it desirable for energy production to be organized in the public sector also.

This feature is the phenomenon of "indivisibilities." In most of the infrastructure, the units to be created must have a certain minimum size if they are to make sense at all. The clearest example is that of roads; the least that is needed in order to have a connection between two centers is the complete length of a road for at least one lane, which already represents a large investment. In hydraulic energy production often at least one dam is needed, or in thermal

6. P. N. Rosenstein-Rodan, "Notes on the Theory of the Big Push," *Economic Development for Latin America*, ed. by Howard S. Ellis, Macmillan, London, 1961, pp. 57 ff.

energy production, a plant of considerable capacity — smaller plants being substantially more expensive. Such indivisibilities constitute an important argument for a big push.

Indivisibilities are generally characteristic of heavy industries, such as steel and basic chemicals, which in a somewhat later phase of development may be important objects for investment. The very phenomenon of indivisibilities may be the reason why it is so difficult to enter the group of the developed economies: it establishes a sort of a threshold, in that below a certain level of industrial production costs are high and incomes low, while beyond that level the relationship is reversed. In order to get over the threshold a big push is necessary. Many of the now developed countries got "over the hump" only by a painful process: the big push is therefore an old problem facing the new countries.

It should not be concluded from the foregoing that a country in the first phases of development should concentrate predominantly on big projects. Smaller projects usually give quicker results which exert a stimulating effect on the economy. Starting with too many big projects may be unwise because of the discouraging effect of the long waiting period. It may also be unwise because of possible inflationary consequences. Often smaller projects can be linked up with existing production units (cottage industry with factories processing the same agricultural produce, for example) so that less sweeping physical changes and psychic switches are necessary. At the same time more people can be trained in managerial skills, and the projects can be spread over a wider area. Also, with smaller projects it is more feasible to experiment to determine which branches of production are particularly suitable for a given country. Therefore a wise choice must continually be made between projects of different size.

CHAPTER 2

TWO DOCTORS

2.1 MOTHER COUNTRIES AND COLONIAL INVESTMENTS

The countries in need of development, and especially those that gained national independence only recently, are now eagerly seeking the means to further, or even start, their economic advance. In the present world they find two doctors who are willing to advise them on how to overcome the illness of poverty — the developed countries of the West and the Communist countries. Both have a record of development to show: the Western countries a long history of gradual advance and the Communist countries one of quicker progress more deliberately fostered, but partly based on Western experience. Both doctors will be judged by the prospective patient not only by their words or present-day policies but also by their historical record. This is only natural, since gaining any information takes time; it is even more natural if the patient's colonial history was painful in some respects. Here we must recall

Arnold Toynbee's analysis of how the West has been judged by the outside world.[1] The leading European countries of the West not only have a history of economic development; they have at the same time a history as colonial powers. And former colonies do not always have the feeling that their mother countries behaved like mothers. The memories of these former colonies have been helpfully nudged by the Communist countries, though in a somewhat one-sided way.

There is no need to make an apology for the Western countries here, since old-time colonialism is reaching its end in any case. For our purposes, however, it does make sense to analyze the colonial era in the light of development, asking whether colonial rule made a sufficient contribution to the development of the colonies, looked at in a modern way.

Economically, colonial rule was characterized by investments of considerable size. During the years from 1900 to 1914 annual capital imports into India from Britain amounted to about 1 per cent of Indian national income,[2] a figure that is doubled when reinvestment of locally made profits is included. It has been estimated that in 1938 about one-sixth of the total national wealth of the Netherlands was invested in Indonesia (then the Netherlands East Indies); this amount constituted roughly one-third to one-fourth of Indonesia's total capital stock.[3] As is well known, these investments were mostly directed to primary production and the infrastructure. A substantial portion of these investments was privately financed and the incentive was simply profits — higher profits than could be earned in the mother countries. The margin was not particularly great, however, as the following figures indicate:[4]

1. See Arnold Toynbee, *The World and the West,* BBC Reith Lectures 1952, Oxford University Press, London–New York–Toronto, 1953.

2. This figure may be compared with an inflow of public capital of 1.2 to 1.3 per cent of national income during the first and second five-year plans.

3. It may be held that the countries cited are relatively unfavorable examples as compared with some less populated colonies. We have chosen our examples precisely because the bulk of the population in underdeveloped areas lives in densely populated countries.

4. See Appendix V for sources and a discussion of the reliability of all figures mentioned in this paragraph.

Interest on Bonds	*UK*	*Colonies*
1870–80		
Government	3.8	4.4
Railways	5.3	6.3
1900–09	3.4	3.6
1921–30	4.5	5.3

Rate of Return on Shares	*Netherlands*	*Neth. E. Ind.*
1900–12	5.7	6.5
1922–29	4.0	7.5
1930–37	3.0	3.2

These investments, together with a flow of technical and commercial personnel, did increase colonial production and income. In the context of private enterprise it was natural that a part of the profits be paid to shareholders living outside the territories. Also, a substantial part of these profits was reinvested in colonial enterprises. Yet the increases in production and income definitely did not lead to the development of the colonies in a manner which we would consider satisfactory today. This may be illustrated by two studies which are in a way complementary.

D. H. Burger in a microanalysis of a region of Java[5] showed that the income increases were concentrated among a small group of producers, mainly immigrants, rather than spread over the indigenous population.

Professor Louis J. Zimmerman, whose figures we have already quoted,[6] uses a macroeconomic approach and confirms a conclusion reached by others, that production increased in proportion to population, leaving income per head unaffected. A fair presentation of the facts might be the statement that Western medical institutions and Western production increases made it possible for a larger population to live at a traditional level than might otherwise have been the case. Whether much has been gained thereby is a question of philosophy.

Having looked at the general quantitative features of development under colonial rule we may briefly discuss three qualitative aspects of colonialism which are of considerable importance to development policies. The first concerns the attitude of colonial gov-

5. D. H. Burger, *Vergelijking van den economischen toestand der districten Tajoe en Djakenan,* Kolff, Weltevreden, 1930.

6. L. J. Zimmerman, *Arme en rijke landen,* Albani, The Hague, 1960.

ernments with regard to industrialization. They have, to say the least, always been very hesitant to further industrialize their dependencies.[7] The idea prevailed that there was a natural division of labor, allegedly based on comparative advantages, making it at least doubtful whether the industrialization of tropical countries was advisable. It is true that some industries were developed in India during the colonial era, but these were not exactly furthered by the British government.

This brings us to a second aspect of colonial rule, trade policy. This has repeatedly been used in favor of the industries of the ruling country and to the disadvantage of local industries or consumers. The record with regard to textiles makes this abundantly clear.[8] As a rather recent example, the quantitative restrictions of the nineteen thirties against cheap Japanese textiles in the Netherlands East Indies may be mentioned.[9]

A third feature refers to the choice of institutions and technologies made by Western technicians working in the colonies. There was an understandable tendency for outside technical and administrative experts to be guided by their own experience, and this was bound to be to some extent an experience gained in their own countries. Thus one is struck by the parallelism in the institutions and techniques of the mother country and the colonies. This often resulted in the imposition of a technology which was not optimal for the economies concerned: it tended to be too capital-intensive. The same error has since been made — and perhaps to an even greater degree — by some American experts working in developing countries. In this case it has little to do with colonialism; it merely reflects the orientation of technology toward the economic conditions prevailing in the developed countries.

7. See, e.g., Benjamin Higgins, *Economic Development*, Norton, New York, 1959, pp. 316, 352–353, 371; J. A. Wartna, *De Indonesische nijverheid—verleden en toekomstmogelijkheden*, Excelsior, Rijswijk, 1961, Ch. 1; P. Prasad, *Some Economic Problems of Public Enterprise in India*, H. E. Stenfert Kroese, Leiden, 1957, Ch. 4.

8. K. M. Panikkar, *Asia and Western Dominance*, Allen and Unwin, London, 1953, pp. 65 ff.

9. G. Gonggrijp, *Schets ener economische geschiedenis van Indonesië*, F. Bohn, Haarlem, 1957, p. 188.

While recognizing that the colonies were primarily governed in the interest of the mother countries, one can at the same time admit that in many instances it was the colonial tie that introduced into the thinking of the colonies a number of Western elements which are basic to a positive attitude toward economic development. This may help them in their further development. It will also make it easier to bring about a "real meeting" between these countries and the West, which is to say a contact in a broader and deeper sense than in economic terms alone. And this will be necessary in view of the ultimate aim of world-wide co-operation.[10]

An important element of Western thinking transmitted by colonial rule was that of geographic integration, the creation of relatively large politically unified areas. The significance of this element will become clear when we discuss (in Chapter 8) some of the tendencies toward disintegration now visible in Africa.

2.2 WESTERN HELP AND ADVICE

Although understandable, it would be a mistake for legislators in developing countries to base their judgment of the potentialities of Western-type societies on the colonial experience only. There are two more pieces of evidence. First, the Western countries' own development should be considered, especially the later stage when the pure laissez-faire and capitalistic features were tempered — mostly by the influence of labor movements — and social relations improved. It should be remembered too that in this stage several groups and individuals became increasingly conscious that "social relations" with the nations which up to then had been colonies should be promoted. The second piece of evidence is the West's changed approach to developing countries after World War II.

The more farsighted among Western politicians and experts understood fairly early that after World War II colonialism would be in the process of liquidation. Relations between India and the United Kingdom are the standard example of the new attitude. To

10. See H. Kraemer, "Grootheid en ellende van het Vasco da Gamatijdperk," *Wending*, Boekencentrum, The Hague, 1959, pp. 403–415.

be sure, less fortunate examples are numerous and often the problems to be solved are more difficult while the skills available for the task are less.

The governments responsible for the creation of the United Nations organization and a number of their specialized agencies were aware, individually and collectively, that other means would have to be made available in the interest of a successful development policy. Assistance in the public sphere with capital and technical knowledge coming from the developed countries was the main element in these new means. The International Bank for Reconstruction and Development (IBRD, or World Bank) was established and various agencies, especially the Food and Agriculture Organization (FAO), organized technical assistance. Somewhat later, when still other specialized agencies, including the United Nations Educational, Scientific and Cultural Organization (UNESCO), as well as the UN Secretariat had organized technical assistance, an attempt was made to co-ordinate these activities. Since 1950 this co-ordination has been in the hands of the Technical Assistance Board (TAB) of the United Nations. Financial assistance is now also given by the International Finance Corporation (IFC), the International Development Association (IDA), and the UN Special Fund (UNSF). An idea of the order of magnitude of the means made available in this way can be obtained from Tables 2–1 and 2–2.

In addition to the preceding activities, usually described as multilateral assistance, so-called bilateral assistance is granted by many countries (see Table 2–3). For Southeast Asia, a special co-ordinating organization has been formed for this purpose, working mainly with the financial support of the Commonwealth — the Colombo Plan. Huge programs of bilateral assistance are those of the United States — formerly the International Cooperation Administration (ICA), now the Agency for International Development (AID) — and of the French Community.

An intermediate position is taken in the case of the assistance given by the European Development Fund (EDF) and the European Investment Bank of the European Economic Community, and by the Inter-American Development Bank (IADB). Some figures

Table 2–1

MULTILATERAL CAPITAL AID TO NEWLY DEVELOPING COUNTRIES, 1954–1961 (in millions)

Total	$1,817
IBRD	1,270
IFC	23
UNSF	131
IDA	101
EDF	162
IADB	130

Note: For IBRD and IFC, estimated net disbursements; for other agencies, loans or grants approved. Years indicate fiscal periods ending that year.

Source: United Nations, *Statistical Yearbook 1960,* New York, 1961; and Annual Reports of the organizations involved.

Table 2–2

MULTILATERAL TECHNICAL ASSISTANCE, 1960[a]

	Expanded Program (in millions)	NUMBER OF EXPERTS		NUMBER OF FELLOWSHIPS	
		Expanded Program	Regular Program	Expanded Program	Regular Program
Total	$ 32.3	2,258	1,046	2,745	4,002
UNTA	7.3	522	331	817	412
FAO	8.4	553	68	408	17
WHO	5.5	430	471	518	2,364
UNESCO	4.9	302	93	321	662
ILO	3.2	251	65	453	203
ICAO	1.5	116	—	54	—
WMO	0.5	35	—	62	—
ITU	0.4	27	—	27	—
IAEA	0.6	22	18	85	344

Note: Expenditure on the regular program is included in the normal budget of the agencies concerned; expenditure on the expanded program is separately budgeted in the Expanded Program of Technical Assistance.

a. For abbreviations, see List of Abbreviations.

Source: United Nations Technical Assistance Committee, *Annual Report of the Technical Assistance Board for 1960,* New York, 1961 (Doc. E/3471).

Table 2–3

BILATERAL ECONOMIC AID TO NEWLY DEVELOPING COUNTRIES, 1954–1959 (in millions)

	Total	Grants	Net Loans
Total	$13,537	$10,366	$3,171
Australia	185	183	2
Belgium	66	10	56
Canada	244	207	37
France	4,117	2,982	1,135
Germany (Fed. Rep.)[a]	76	5	71
Italy	161	42	119
Japan	179	179	—
Netherlands	~~105~~ 119	119	14
New Zealand	27	26	1
Norway	4	4	—
Portugal	15	1	14
Sweden	2	2	—
United Kingdom	869	615	254
United States	7,476	5,991	1,485
Yugoslavia	11	. . .	11

Note: Years indicate fiscal periods ending that year.

a. 1959 only.

Source: United Nations, *Statistical Yearbook 1958,* and *1960,* New York, 1959 and 1961.

concerning the latter type of assistance were given in Table 2–1.

While the activities just summed up are of a public character, private investment continues to contribute considerably to the flow of investment funds as Table 2–4 shows. A large percentage of this investment has been concentrated in the oil industry.

Some figures summarizing all these activities in the field of capital aid are presented in Table 2–5.

The nature of the technical assistance, as well as the conditions sometimes set for the capital aid granted, were inspired by what Western experts and government and financial circles believed to be

Table 2–4

NET FLOW OF PRIVATE CAPITAL TO NEWLY DEVELOPING COUNTRIES, 1956–1959 (in millions)

	Total 1956–59	1956	1957	1958	1959
Total	$11,273	$2,975	$3,514	$2,506	$2,278
United States	4,639	1,251	1,827	872	689
United Kingdom	1,998	402	690	518	388
France	1,622	461	359	378	424
Germany (Fed. Rep.)	1,086	275	247	240	324
Netherlands	588	215	124	145	104
Other developed countries	1,340	371	267	353	349

Note: The figures exclude short-term capital (less than one year). They include guaranteed export credits and reinvested earnings.

Source: OEEC, *The Flow of Financial Resources to Countries in Course of Economic Development 1956–1959,* Paris, 1961.

the most efficient policy of development. Since ideas are free in Western countries, the advice reflected various shades of opinion ranging from a strong recommendation of private initiative, wherever possible, to the suggestion of a mixed system adapted to the potentialities of the recipient countries. Much advice was given also on the financial and monetary structure and more particularly on the type of foreign exchange policy to be adopted. This advice usually centered around "orthodox" financial policies and the abolition of multiple exchange rates and discriminatory trade practices. It is only natural that the experts and government representatives should benefit from experience, and a clear development is apparent in the content of their advice (see Chapter 6).

Apart from recommendations believed to be in the interest of the countries helped, the West's policy has also been characterized by some less fortunate features, intentional and otherwise, which have changed recently. In the beginning, rather stringent political ties were a prerequisite to the aid given. For years India was not offered much assistance because her "neutralist" attitude was dis-

Table 2–5

TOTAL FLOW OF CAPITAL TO NEWLY DEVELOPING COUNTRIES, 1956–1959 (in billions)

Total	$28.6
Contributions to multilateral agencies	1.9
Bilateral contributions:	
Official	15.5
Grants	9.6
Net lending	5.9
Private	11.2
Guaranteed export credit	1.5
Other new lending and investment	6.1
Reinvested earnings	3.6

Note: The figures exclude short-term capital (less than one year) and military expenditures. Contributions to multilateral agencies as reported here are higher than actual disbursements of these agencies as given in Table 2–1, because of the balances accumulated by the agencies. The figures given in this table for Official Bilateral Aid differ from those given in Table 2–3 mainly because of differences in the definition of assistance and in the basis of reporting. For further discussion of these points see the Annex to *International Flow of Long-Term Capital and Official Donations 1951–1959*, United Nations, New York, 1961 (Sales no.: 62.II.D.1).

Source: OEEC, *The Flow of Financial Resources to Countries in Course of Economic Development 1956–1959*, Paris, 1961, and estimates of the Netherlands Economic Institute, Rotterdam.

liked, especially by the American public. Smaller countries were given aid with political conditions. A most unfortunate game was played with the United Arab Republic (then Egypt) in the withdrawal of a proposal to finance part of the Aswan High Dam project.

Apart from governmental intentions, some experts did violence to the intentions of the aid programs by a personal attitude irritating to the recipient countries. In some cases it was an attitude of knowing everything better; in others, a lack of adaptability to the circumstances of the country, and a tendency to luxurious living. It is a tribute to the American way of life that such attitudes were publicly ridiculed and criticized,[11] and it should not be overlooked

11. See W. J. Lederer and E. Burdick, *The Ugly American*, Norton, New York, 1958.

that many other American experts did very good jobs. Moreover, errors were certainly not committed only by the foreign visitors. It is part of the phenomenon of underdevelopment that many things are done, individually and collectively, in developing countries which are, to say the least, not helpful in attaining the desired goal.

One of the important developments during the relatively brief period under review is the changed attitude of Western experts toward economic planning. While planning at a project level was seen as necessary from the start — bankers usually like planning for their clients better than planning for their own governments — the planning approach for a nation as a whole was not given its proper place. Thus the programs recommended by IBRD missions in the earlier years often fell short of what was needed to attain real development.[12] Nowadays it is generally recognized by organizations like the World Bank and the ICA and by most individual Western experts that a developing country must have a development plan to serve as a framework for the program of projects to be carried out. Several countries understood this necessity soon after independence; some countries, particularly in Asia, already have an interesting record in this respect. Planning techniques evolved quickly and a reasonably good set of not too complicated techniques is now available.[13] At the same time the staff needed for such planning is rapidly increasing, although there is still a definite shortage. Also, it has become clear that to have a plan is not enough; it must be effectively implemented. This means that instruments must be chosen to influence the actual course of development when it is not in conformity with the plan. In order to judge the efficiency of such instruments so-called short-term decision models or policy models of the particular economy are very useful: these summarize the most important forces in the economic mechanism relevant to short-term policy.

12. F. T. Moore, *The Failures of the World Bank Missions*, RAND Corporation, Santa Monica, Calif., 1958.

13. An outstanding survey of the most important techniques available may be found in H. B. Chenery and P. G. Clark, *Interindustry Economics*, Wiley, New York, 1959. See also H. B. Chenery, "Development Policies and Programmes," *Economic Bulletin for Latin America*, March 1958, pp. 51 ff.

Planning techniques, as just advocated in a general way, are also very useful in the preparation of the many types of education and training processes needed for development. The latest step in techniques and activities applied by experts assisting developing countries is directed at using planning techniques in these areas.

2.3 THE RUSSIAN PERFORMANCE

The economic history of the countries united in the Soviet Union (the West continues to speak of Russia, which is by far the most important country in the Union) since the 1917 October Revolution has been dramatic. Strong forces have been involved on various sides. This was true of the circumstances in which the Revolution took place; it was true of the attempts made by reactionary forces from outside to interfere with the political situation in Russia; it was true of the opposition from certain groups of the population, especially of the peasantry; it was true of a number of measures instituted by the regime. Russia also went through the Second World War and suffered tremendous losses in people and material wealth which required huge efforts at reconstruction. Accordingly, the economic history of the Union has not been uniform; it has been marked by serious setbacks. Only a brief summary and appraisal of this unprecedented attempt to reshape an economy can be given here.

An outstanding question which must be answered in order to make such an appraisal is, of course, whether Russian development has indeed been more rapid than the development of the Western countries, as the Communist Party claims — and as a number of Western economists deny. The comparison, to begin with, is not an easy one. The statistical evidence available is based on concepts and sometimes on methods which are different from those used in the West. A vast literature has come into existence on this subject. Another major difficulty is the choice of comparable periods. Simply to compare the Soviet Union with the United States over the same period is to compare a developing economy with one which is highly developed. A more appropriate comparison may be to take periods starting with the same quantity of production. That is what G. Warren Nutter has done;[14] he compared industrial production as a whole and in a large number of industries by determining the lag of Russia behind the United States in years. Nutter finds that for steel ingots the Soviet Union lagged 21 years in 1913, 32 years in 1937, and 29 years in 1955. Using the same benchmarks the median figures for 37 industries are 28, 36, and 35 years. For per capita production there is an increase in the lag between 1913 and 1937 of 10 years; between 1937 and 1955 the increase amounts to 4 years.

For more recent years R. Wagenführ has made a comparison between the industrial production of the USSR and of the United States.[15] This shows that in 1956 the industrial production of the USSR was from 44 to 48 per cent of that in the United States while in 1959 the range was from 57 to 62 per cent.

Nutter's figures over the period starting in 1913 are not too helpful since in that period, ending in 1937, the Russian economy went through the destruction of the revolutionary and antirevolutionary fighting following the First World War. The figures over the 1937–1955 period are more significant, but here the Second World War is involved. This certainly brought about much more devastation in the Soviet Union than did the First World War in the United States, which was then at a comparable stage of development. If anything can be concluded from the figures then, it is that Russian over-all development has been more rapid than American development.[16]

Further analysis is required, however, before it can be concluded that the Communist regime is more effective in bringing about growth. Effectiveness can be determined by a comparison between

14. G. Warren Nutter, "Some Observations on Soviet Industrial Growth," *American Economic Review,* May 1957 (Papers and Proceedings of the Sixty-ninth Annual Meeting of the American Economic Association, 1956), p. 618.

15. R. Wagenführ, *Croissances industrielles comparées de la Communauté Européenne, des USA et de l'URSS,* Centre de Recherches Européennes, Université de Lausanne, Lausanne, 1961.

16. The same conclusion is reached in more elaborate studies; see, for example, Abram Bergson, *The Real National Income of Soviet Russia since 1928,* Harvard University Press, Cambridge, 1961, Ch. 14.

output on the one hand and efforts and sacrifices on the other. Among the efforts and sacrifices are the means used, in the narrower sense – including goods and the human capital invested in education. Possibly more of these means could have been used to good effect by the Western economies. Before dealing with these comparisons we must first consider the most characteristic features of the Communist economies – called, as we know, "socialist" by their leaders. They may be listed as follows:

(i) most of the means of production are community property;

(ii) the economic process is centrally planned in considerable detail;

(iii) a large portion – of the order of 25 per cent, in Western concepts – of national income is saved and invested, meaning that consumption is kept at a lower level than income permits;

(iv) the educational system tries, more deliberately than in Western societies, to use individual talents for the furtherance of economic and scientific development;

(v) deviations in economic behavior from the official policy are severely punished.

Many more features might be worth recalling for the reader, but we believe that the five mentioned are the most important ones. Some others can be deduced from those listed. Thus it is a consequence of (i), (ii), and (v) that there exists considerable central guidance with respect to the choice of technology and the size of productive units. A corollary is the avoidance of waste due to uneconomically large or small plants. Other key central decisions relate to the division of production between capital goods and consumer goods and between different kinds of consumer goods. The latter at the same time influences the relation between individual consumption and saving as well as the individual pattern of consumption. An interesting example of the allocation system is the fact that means of mass transportation have been emphasized while few resources – in contrast to the situation in the West – are used for the production of private cars. Another example is found in communications: advertising is practically absent, except for extensive official propaganda.

Depending upon ideology, there is a definite difference in the appraisal of the role played by the five main features in the success of the regime with regard to development. Official Communist opinion emphasizes (i), (ii), and (iv) as the main factors. Western opinion tends to attach primary importance to (iii) and (v), some importance to (ii), and increasing importance to (iv). Western opinion is not unanimous on the question of government ownership of the means of production. Thus conservatives hold that (i) is indeed an adverse influence while more progressive circles do not think that it has much connection with development, except for a number of key industries which in many Western countries are also publicly owned (infrastructure and some heavy industries). Western opinion is fairly uniform, however, in considering (v) a far more serious drawback of the Communist system, mainly for non-economic reasons, than official Communist opinion admits.

If we now want to compare the economic value of the two systems with respect to growth we must start by considering the ratios between output and means in the narrow sense; in other words, the ratios between increased production obtained and capital invested (including education). It is a pity that precise and comparable estimates of this yardstick, which in its crudest form coincides with the output-capital ratio, do not exist. The available figures tend to favor the Communist countries, but this is partly because investment in housing, which is known to be characterized by a low output-capital ratio, was for a long time neglected.

The relatively high level of capital investment in the Communist economies must then — evidently — yield relatively impressive results. So we think the most appropriate Western comment on Communist development may be that it is only natural that development can be speeded up if a sufficiently large portion of national income is invested and, further, that account must be taken of the sacrifices made in the form of a low level of consumption and the restraint of freedom.

Apart from the main features of communism already discussed one other feature may be of increasing importance, namely change. The Soviet system does not remain the same, any more than the Western system. Both are moving and the movements are, generally speaking, converging ones.[17] Thus some ideas which sprang from early Communist preferences but proved difficult to apply have been given up. It is no longer held that workers can manage productive units by themselves, that all incomes should be more or less equal, or that money is superfluous. Incomes are geared to productivity and money concepts are increasingly used in planning. Interest, though not recognized as a possible source of private income, has gradually been accepted as representing a real cost element. The value of an international exchange of products has been increasingly understood and some autarkic preferences weakened. Some decentralization in economic decision-making has been introduced and consumption has been given more attention in the new party program. Mathematical methods in economic planning, at first considered "bourgeois," are now increasingly applied.

2.4 THE GROWTH OF EASTERN EUROPE AND CHINA

Since World War II the Soviet Union has not been the only country under Communist rule. At various moments and in various ways a number of Eastern European countries together with China and some smaller Asian nations have come under the dominance of their Communist parties. Some of these economies, especially Czechoslovakia and the German Democratic Republic, were more developed than the Russian; China was probably the least developed major country in the world. In all of them a vigorous policy of economic reconstruction and economic development has been applied, using Russian experience, suggestions, and methods along with domestic resources.

The economic development of these countries has been quick,

17. See J. Tinbergen, "Do Communist and Free Economies Show a Converging Pattern?," *Soviet Studies,* 1961, p. 333.

largely for the same reasons as in the Soviet Union. Underdeveloped regions, such as Slovakia, have been developed. Heavy industries have been established in practically all of the countries, partly for armament purposes and partly because of the belief that every country should have its own heavy industry. The process has been accompanied by a tendency toward autarky, although the size and character of the Eastern European countries has not permitted the full application of this principle. More recently the economic policy and planning of these countries has undergone some clear changes with respect to international trade. While the international exchange of products was in the beginning a matter for bilateral negotiations, more co-ordination and international planning have been introduced. No important powers in these fields, however, have been given to supranational agencies: national autonomy is guarded very carefully.

Gradually some differences have evolved between the systems of the countries under Communist rule. Yugoslavia was the first country to follow its own course and it has devised a system with some remarkable features in line with the national character of the Republic. A high degree of decentralization has been introduced in production and in investment decisions and pricing. It may be said that Yugoslavia now is a competitive economy of factories owned by the various lower and higher public authorities or by the workers as a group, with an interventionist central policy. Large numbers of small enterprises are, in practice, private.

After 1956 the other Eastern European countries introduced changes in their economic regimes and their economic policies. Like Yugoslavia, Poland adopted more decentralization, though not in pricing. More emphasis was laid on indirect influences on management and central planning was done in less detail than before. In all of these countries consumption was given more attention.

Since 1952 China too has shown a rapid development. The character of the country and its culture makes it very difficult to compare its development with that of the European countries. China's income per head is extremely low and a very large portion of its production is still agricultural. In consequence China is even more susceptible to random changes in crop yields than the other Communist countries. As in Russia, there have been rather violent alterations in the approach of the regime to agriculture. But China develops her own ideas with regard to the agricultural system as well as in many other fields. Differences in emphasis in matters of foreign policy clearly illustrate this point. While the progress in production made by China has been one of jumps and setbacks, it has been sufficiently large to impress neighboring countries like India and Indonesia.

2.5 COMPETING DOCTORS

As is now generally understood, the Western and the Communist systems are in a competitive position vis-à-vis the developing countries. It is in the interest of the latter that objective judges make as precise an appraisal as possible of the relative merits of each. This means, first of all, that objective information must be abstracted from the influences of propaganda and emotion. Both of these play a considerable role, as can be understood only too easily. To the extent that they cannot readily be eliminated, the West must try to make its propaganda as effective as that put forth by the Communist countries. The best means of protection against the influence of propaganda which is not based on facts is the nurture of critical abilities in the developing countries.

An evaluation of the two systems should entail:

(i) a statement of the differences and their probable influence on development; and

(ii) an appraisal of these differences and influences by the value standards of the developing countries.

The fundamental difference between the two systems from the standpoint of economic policy lies in the disparity between the number of instruments of economic policy at their disposal. The number is much larger in the case of the Communist countries. In general, a larger number of instruments makes it possible to reach a set of goals with more precision than a smaller number of instruments. In plain terms, Western economies may more easily get out of control. They may and generally do reveal instances of individual interests being served in opposition to community interests and of very unequal income distribution, partly as a consequence of private ownership of the means of production.

The main drawback — in the restricted economic sphere — of the Communist system and the corresponding advantage of the mixed system of the West is to be found in the level of efficiency of the instruments available. A multiplicity of instruments necessarily leads to red tape and friction; it discourages quick action at the lower level, say the level of the single factory or the single man. Free enterprise and private ownership of the means of production do, in contrast, stimulate action at the lower level. An appraisal of the relative effectiveness of the two systems turns on estimates of the strength of these opposed forces: more precise guidance with perhaps less stimulus in the Communist system, less precise guidance with perhaps more stimulus in the mixed system. Unfortunately our knowledge of the quantitative effect of these forces is still so rudimentary that no clear judgment is possible. It was stated earlier that one of the first crude criteria, the output-capital ratio, has not yet been measured accurately enough to draw conclusions.

Apart from these objective measurements, the appraisal by developing countries is different from that by developed countries, for the latter attach a much higher value to freedom as such. The weight given an increase in production, on the other hand, will be greater in developing countries than in developed countries, because of the lower level of consumption.

The foregoing makes it understandable that the Communist system has a considerable attraction for certain groups of politicians in developing countries. The most important contribution the economist can make is to point out that the choice is not necessarily a choice between the extremes, rather it is one of an optimum combination of institutions and instruments in every case.

There is a second form of competition now going on between the two systems or rather, in this case, the two groups of developed

Table 2–6

GOVERNMENTAL AID TO NEWLY DEVELOPING COUNTRIES: A COMPARISON OF THE WEST AND THE SOVIET AREA, 1956–1959
(in billions)

THE WEST				SOVIET AREA			
	Total	Grants[a]	Net Loans		Total	Grants[a]	Net Loans
Total	$14.64	$10.16	$4.48	Total	$0.60	$0.03	$0.57
United States	8.42	5.57	2.85				
France	3.36	2.73	0.63				
United Kingdom	1.03	0.72	0.31				
Germany (F. R.)	0.48	0.13	0.35				
Other West	1.35	1.01	0.34				

Note: The figures are estimates of actual disbursements. They exclude military aid, private financing, postwar reparations and indemnification payments. It should be noted that Sino-Soviet area commitments (as distinct from disbursements) for credits and grants, excluding military aid, totaled $2.3 billion for the same period. Both figures exclude aid transactions inside the Sino-Soviet bloc.

a. Including contributions through multilateral agencies.

Sources: "Aid in Perspective," *The Economist,* August 16, 1961, pp. 788–790; OEEC, *The Flow of Financial Resources to Countries in Course of Economic Development 1956–1959,* Paris, 1961, p. 9.

countries — competition in financial and technical assistance. The common philosophy evidently is that the process of development can be accelerated if foreign capital is added to domestic savings and foreign knowledge is offered to build up production units and train people. In addition it is believed that such help will be appreciated by the countries receiving it.

The West has an advantage in this type of activity in that it has more resources at its disposal. Accordingly the total aid given by Western countries greatly surpasses the help given by Communist countries, as Table 2–6 shows. Despite this, the West has not fully utilized its potentialities. This not only hurts the competitive position of the West but, what is worse, it does a disservice to the underdeveloped countries, and hence to the cause of international solidarity. In addition the publicity — or propaganda — accompanying the foreign aid struggle has been more effective on the Communist side.

The competition between the two systems as well as the decisions which the underdeveloped countries will finally take are of great importance to the upcoming economies and to the world at large. As already observed, there should be an awareness on all sides that the decisions are not necessarily between black and white alternatives. It is not true that the systems are diametrically opposite, nor even that they are unchanging and unchangeable. The two already have many features in common; elements from each can be combined, leading to new mixed systems. The present Western economies are themselves a mixture between pure 19th century capitalism and socialism. Both systems will continue to learn from experience, and from each other, and will continue to change. Economic science teaches us[18] that the optimum probably is a mixed system. Economic forces will therefore be at work tending to move both systems toward the optimum. It is of extreme importance that further research be undertaken to develop this theme and to collect more precise information.

18. See J. Tinbergen, "The Theory of the Optimum Regime," *Selected Papers*, North-Holland Publishing Company, Amsterdam, 1959, p. 264.

CHAPTER 3

THE CRUSADE AGAINST PROTECTION

3.1 THE OLD CONTROVERSY: STATE OF THE DEBATE

Our analysis of the world's tensions led us to concentrate on the problem of underdevelopment. So far we have discussed this problem in terms of the economic conditions prevailing in the less developed nations. Now it is time to turn to the external conditions confronting the developing countries, and we will begin with a discussion of trade policy. The postwar era has been characterized by a crusade against protection. This has taken the form of an organized attempt to reduce trade barriers, against the opposition of manifold forces and interests.

The controversy between advocates of free trade and advocates of protection is one of the oldest in modern economics. Trade policy is among the important instruments of economic control, and what form it takes is of significance to today's underdeveloped countries. More than a century of experience, intensive discussion, and analysis has left us with relatively sophisticated and temperate views on the subject; hence more agreement is possible than in the past. In this section an attempt will be made to summarize the current state of the debate over theory. Subsequent sections will be devoted to the practical arguments.

We must realize that the concepts of free trade and protection are not equally definitive. Free trade is a more precise term than protection, for protection is a relative matter. There may be a greater difference between a high-tariff policy and a low-tariff policy than between a low-tariff policy and a free-trade policy. For policy-making purposes, the significant need is to indicate what level of protection is optimal; as a limiting case this level may be zero, meaning free trade. It must be added that there is a clear asymmetry in the assumptions made when a protectionist as opposed to a free-trade policy is recommended. Protection is usually advocated as a second-best solution. This may be illustrated by the "optimum tariff" thesis. According to this thesis a relatively large country can maximize its real national expenditure by the imposition of an import tariff which will favorably affect the terms of trade, i.e., the price ratio between export and import goods. The case for an optimum tariff can only be proved in terms of the national interest of the country under consideration, that is, in terms of a restriction — which makes it a second-best policy. The infant-industry argument also rests on a restrictive assumption, namely the impossibility that industrial growth can be better promoted by other means, such as lump-sum subsidies. Actually, such subsidies have the advantage of not distorting the marginal decisions of producers and consumers, and in this respect they permit a closer approach to the optimum of well-being. Finally, it should be realized that mixed solutions are possible, a fact which deprives the issue of much of its clarity.

The position can best be characterized by stating the conditions which must obtain in order to prove the case for free trade. Protection will then emerge as the second-best solution in a number of exceptional cases, covering an important segment of reality.

Free trade can be shown to be compatible with maximum well-being for the world provided that:

(i) income is sufficiently redistributed among citizens within each country and among countries themselves;

(ii) temporary subsidies are given to young industries which have not yet reached a normal level of productivity (infant industries);

(iii) subsidies are given to support industries so vital that no interruption of supply can be tolerated;

(iv) subsidies are given to retrain workers, and to facilitate the transfer of capital from declining industries to new and profitable ones.

As indicated, free trade can exert a favorable influence only within the framework of other institutions; it may not be the best regime if certain conditions are not fulfilled. Condition (i) is the most fundamental; it implies that in the absence of sufficient income equality some protection may yield a better result.[1] Of course the question is, what is a "sufficient" degree of equality? Theoretically, it would be such as to equalize the marginal utilities, or the satisfactions, derived from the last dollars of all personal incomes. Practically, this must be interpreted to mean the maximum degree of income equality which is compatible with the other aims of economic policy. As for the distribution within national boundaries, the income distribution of the socially most advanced countries may serve as an immediate objective for developed societies and as a long-term goal for developing societies. The socially most advanced countries may be Scandinavia in the Western world and Poland or Yugoslavia in the Communist world. The question of the income distribution among countries will be taken up in Chapter 6.

1. See J. Marcus Fleming, "The Optimal Tariff from an International Point of View," *Review of Economics and Statistics,* February 1956, pp. 1 ff. Fleming makes this point a main issue in his plea for protection by underdeveloped countries — considered as a group.

Condition (ii) expresses the belief that it is in the general interest that industries which in the long run will become competitive be supported in their early stages. As stated above, lump-sum subsidies are theoretically the best type of help because they do not falsify the marginal decisions of producers and consumers. In plain language this means that it is better to keep prices at a competitive level and subsidize producers than to protect them by an import duty to be passed on to consumers in the price they pay. High prices reduce consumption and promote undesirable substitutions.

Condition (iii) refers to the fact that since international trade is subject to interruption in times of stress, a country is well advised to produce essential commodities at home even though this is more costly than acquiring them abroad.

Because capital goods are long-lived and skills are difficult to acquire, changes in data over time are likely to lead to a sub-optimal use of the factors of production. In condition (iv) we take the position that subsidies may reduce these losses by bringing about a quicker change-over than would otherwise occur.

In cases (ii)–(iv) the point is that free competition, and thus free trade, will not by itself lead to an optimum use of resources; other devices must be incorporated and subsidies are preferable to protection. The case for some protection can be made only if the "cost" of subsidies (including all of the sacrifices connected with them) is greater than the cost of protection (including the consequences stemming from the falsification of marginal decisions).

This means that protection — at a level to be specified later — can be defended (a) for underdeveloped countries:

(i) if they have an insufficient share of the world's income; and

(ii) if it is difficult or impossible to organize subsidies for industries which have not yet reached their optimum size;

and (b) for all countries:

(iii) if it is difficult or impossible to organize subsidies for vital industries, such as agriculture, which have to be operated even at a loss to guard against any interruption of supplies; and

(iv) if it is impossible to finance measures designed to enhance the mobility of capital and labor in any other way.

In some circumstances protection can also be defended as an instrument of retaliation, or as a means of improving the bargaining position of a victim of unfair practices by others.

As an indication of the state of the debate in practical policy we may consider the rules of the General Agreement on Tariffs and Trade (GATT) and their application. These involve the acceptance of tariffs for infant industries in underdeveloped countries. They permit quantitative restrictions in the case of balance of payments difficulties in developed as well as underdeveloped countries, although the rules are more lenient with regard to the latter.[2]

The GATT rules concerning government assistance to economic development are to be found in Article XVIII of the General Agreement. In paragraph 1 of this article in the original text (1947) it is stated that: "The Contracting Parties recognize that special governmental assistance may be required to promote the establishment, development or reconstruction of particular industries or branches of agriculture and that in appropriate circumstances the grant of such assistance in the form of protective measures is justified." Tariff protection therefore is accorded complete recognition by the Contracting Parties.

Remarkably, this article was rarely applied though it was discussed in detail during the preliminary consultations. The explanation is probably to be found in the many possibilities of escape via other articles. In the ninth session (1955) a completely new Article XVIII came into being. Again a large number of specific regulations were added in order to give a precise meaning to this exception to free trade. The main improvement, however, is the more positive phrasing employed, as follows: "The Contracting Parties recognize that the attainment of the objectives of this agreement will be facilitated by the progressive development of their economies, particularly of those Contracting Parties the economies of which can only support low standards of living and are in the early stages of development." Means available for developmental purposes are described in paragraph 2, viz.: "(a) sufficient flexibility in

2. See Articles XII and XVIII.

their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry and (b) quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development."

The new text makes a clear distinction between countries which have "low standards of living and are in early stages of development" and other countries.

Article XIX deals with "emergency action on imports of particular products": "If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession."

Although this article specifies rather narrowly the situations for which it is intended, it could probably also be invoked to cover cases of temporary protection during a transition period in which resources are shifted to other occupations.

Thus the GATT rules are in line with our cases (ii) and (iv) in which protection can be defended. As for case (i), developing countries usually will have balance of payments difficulties as a consequence of a "continued high level of demand for imports likely to be generated by their programmes of economic development" (Art. XVIII, 2, b), so that as a general rule this case will be covered too.

3.2 ITO, GATT, AND REALITY

The actual situation with regard to trade policy is rather different from the ideal situation and from the aims of GATT. It is well known that the GATT aims are a more modest edition of the original aims of the International Trade Organization (ITO). In fact, ITO as first proposed paid more attention to the relationships between trade policy and general economic policies than did its successor, GATT.

An analysis of the postwar history of trade policy and negotiations in the international field may help us understand some of the present difficulties, but it should not induce a feeling of resignation. The trade policy of the past has been characterized by a considerable degree of protection, protection invoked by countries not justified by circumstances in employing it. Apart from the war, which made trade impediments temporarily unavoidable, tradition in several important countries must be blamed for this unhappy situation. Whenever technical and economic development led to the rise of new industries in some countries, vested interests in other countries asked for protection. Governments have not, as a rule, been the strong counterforces to the protectionists which they should have been in the interest of consumers and export industries. This is partly because a considerable interest is involved in the industry seeking protection, whereas for consumers and export industries smaller interests are at stake in any one case of protection, though consumers are numerically the largest interest group. The protection-seeking industries have also been successful because they have maintained better lobbies than the other interested parties. In general we may say that governments have made a mistake in not granting protection on a temporary basis and at a decreasing rate. Infant industries should be protected only until they attain sufficient scale to enable them to compete.[3]

Governments have been slow to participate in the postwar crusade against protection. Because of political pressures, governments were not given wide powers to reduce tariffs. Also, many governments were themselves unwilling to permit international discussion of some of their restrictive measures, such as internal taxes on specific products. Discriminatory internal taxes were not admitted

3. It may be stated here that the Dutch government only grants protection to new manufacturing industries on the basis of such a scheme.

to be negotiable in GATT, although their restrictive effect is much the same as that of import duties. This is not to say that no results have been obtained. There have been several encouraging developments, but they have been confined to relatively small groups of countries or have required a disproportionate amount of effort.

As an example of a laggard attitude the policy of the United States government may be mentioned. This policy precludes overall tariff reductions and requires item-by-item negotiations, often with one government at a time. It is therefore very time-consuming and inefficient — even when the most-favored-nation clause generalizes the result. Other countries, like the United Kingdom, are not much better as a rule. This is evidence of a "fear of commitment" which inhibits the West in matters of foreign trade. It is a fear which takes various forms and affects other policies besides those pertaining to trade.

Another example of an unsatisfactory policy is to lower import duties while increasing internal taxes. Such a policy was applied by Germany in the case of coffee.

A particularly unsatisfactory aspect of trade policy is the imposition of quantitative restrictions on goods from low-wage countries, especially Japan, India, and Hong Kong. Two elements must be distinguished when considering the problem of this policy. One encompasses the trade between Communist and non-Communist countries. This problem will not be specifically dealt with in this study; it will be mentioned only in Chapter 10, where the relationships between these two groups of countries are given some attention. The other element is the one of trade, within the non-Communist area, between developing and developed countries, or, as it is sometimes put, of "trade with low-wage countries."[4] The idea that a special policy is necessary in dealing with low-wage countries rests on an erroneous interpretation of economic relations and facts. Low wages by themselves are not a threat, since they are usually the consequence and expression of a generally low level of produc-

4. For both elements see Harlan Cleveland, ed., *The Promise of World Tensions*, Macmillan, New York, 1961, p. 54; the remarks made there seem pertinent.

tivity and, for all industries combined, just compensate for this lack. As a normal phenomenon this implies that industries which are more productive than the national average will have lower prices while industries which are inferior in this respect will have higher prices.[5]

When Japan joined GATT in 1955, a number of countries reserved the right to maintain quantitative import restrictions on the ground of Article XXXV.[6] Member countries not invoking this privilege felt the full force of Japanese competition. As a consequence, Germany, which had not taken advantage of Article XXXV, resorted to "administrative restrictions" with regard to the import of Japanese cotton fabrics. After she was reproved in GATT meetings she gradually reformed. Italy applied similar restrictions.

5. Interesting examples have been given by Sir Donald MacDougall in "British and American Exports," *Economic Journal,* 1951, pp. 707 ff. At the time of this investigation the average level of productivity of the United States was double that of the United Kingdom. In pig iron, motor cars, and machinery the United States was from 3.6 to 2.7 times as productive, and accordingly it had a much larger share of the world market. In cement, woolen, worsted, and cotton spinning and weaving, on the other hand, the United States was less than twice as productive as Britain, and here American shares in the world market were very small in comparison with British.

The Japanese situation is just as diversified. While the prices of some commodities are much lower than in the United States, in many other instances Japanese prices are higher than American. This is shown by a table presented in a study by C. Tsukuda ("The Role of Wage Costs in Japanese Exports," *Selected Papers,* Six-Month Diploma Course in Economic Planning and National Accounting, Institute of Social Studies, The Hague, 1961, Part II, Table 5):

Price Ratios (Japan/USA) for Selected Commodities, 1954–1955

Motor gasoline, etc.	2.167	Canned tuna	0.337
Refined sugar	1.947	Socks for men	0.565
Zinc ingots	1.577	Viscose rayon	0.613
Ammonium sulphate, etc.	1.561	Cotton fabrics, standard type	0.700
Wire	1.343	Urea resins, etc.	0.740
Newsprint, wrapping paper	1.330	Cordages (sisal)	0.803
Caustic soda, soda ash	1.273	Cotton yarn, 20, 30, 40	0.820

6. Art. XXXV: "This Agreement, or alternatively Article II of this Agreement, shall not apply as between any contracting party and any other contracting party if:

"(a) the two contracting parties have not entered into tariff negotiations with each other; and

"(b) either of the contracting parties, at the time either becomes a contracting party, does not consent to such application."

Toward the end of 1960 a provision concerning "market disruption" was accepted by GATT. It may be considered a refinement of Article XIX on emergency action. In cases of market disruption the contracting parties are empowered to seek constructive solutions consistent with the basic aims of GATT. This decision led to the acceptance of a "short-term agreement" on trade in cotton fabrics in 1961. It provides that during one year importing countries can limit their purchases from the various supplying countries to the amount taken in the previous year. An element of discrimination is implicit here. It is true that the exporting low-wage countries themselves signed the agreement, but it seems clear that if they had not done so some importing countries would have interpreted the decision on market disruption to mean that they had the right to autonomous discriminating protection.

The 1961 agreement was followed by a long-term arrangement which will be discussed later (see section 8.7, p. 158).

Our thesis that there is no need to be "afraid" of low-wage countries is illustrated by the fact that these countries are just as afraid of us as we are of them – and with a bit more justification, since we enjoy the advantage of increasing returns on indivisibilities much more than they do. As long as prices are calculated correctly – and here we face another question – there is no point in excluding low-wage products from foreign markets. It is precisely from such comparative advantages that international trade derives its *raison d'être*.

Measures against dumping can be justified, but as temporary measures only. Dumping is an expression of disequilibria which will not as a rule persist. It is necessary, from an industry point of view, only as long as capacity surpasses demand at normal prices. It may be used as a means of entering a certain market, but it is not in the interest of a country to dump persistently or on a broad scale. A condition of overcapacity in one industry will automatically stimulate the development of other industries, provided general depressions are avoided. Also, with the over-all development of a country, wages will rise. All these considerations tend to support provisions against dumping, but on a short-term basis only.

The trade policies and, closely linked with them, the exchange policies of many underdeveloped countries are complicated and unsatisfactory. High import duties, severe and changing quantitative restrictions, multiple exchange rates, and long payment delays are some of their best known features. This situation has one central cause: a balance of payments deficit on current account, which is identical with a surplus of national expenditure over national income. This must be understood in the light of the desire of the economically lagging countries to develop more quickly, and the well-known slow growth of their export markets. Part of the protectionism of these countries can be justified on the basis of the infant-industry argument, although one doubts whether some of the industries concerned will ever become competitive.

Western experts and international agencies like the IBRD and the International Monetary Fund (IMF) usually advise underdeveloped countries either to reduce their expenditures or to raise more taxes. This is technically correct, but it underestimates the institutional difficulties which these countries face. The simplest solution, namely more foreign aid, is not altogether a bad one, since it is desirable in itself and may help in the long run to eliminate the institutional problems.

3.3 BIG POWERS AND GIANT POWERS: THE NUISANCE OF *KLEINSTAATEREI*

The reduction of trade impediments among smaller groups of countries constitutes a separate chapter in the story of world trade since the war. Europe has been particularly active in this field. The movement toward European integration originated because countries previously considered "big powers" felt that the world was becoming dominated by "giant powers," nowadays the United States and the Soviet Union, soon possibly China and India.

France, Western Germany, and Italy, and also to some extent the United Kingdom, became more and more conscious of this shift in emphasis. Smaller countries had already realized that their influence could only be exerted through some form of co-operation.[7] After World War II Western European countries generally felt that for political and economic reasons some form of integration was desirable, if not imperative. Politically, only a unified Europe could play a role comparable to that of the two giants — and the possible future giants in Asia; economically, the idea was that prosperity depends on the size of the market. To be sure, the popular idea sometimes expounded, that America's prosperity is mainly due to the size of its market, is grossly exaggerated. By far the most important factors are capital per head and technical and organizational skill. Both are considerably higher in the United States than in Europe and probably explain most of the difference in well-being. But it cannot be denied that a big uniform market will stimulate competition, specialization, and productivity. It will also reduce the waste inherent in a large number of small political units. The phenomenon of fragmentation was characteristic of 18th century Germany, where it was known as *Kleinstaaterei;* it was overcome toward the end of the 19th century — though imposed on Germany again to a degree after the Second World War for fear of Germany's power. It exists today in Western Europe if that area is considered as a whole. No doubt the phenomenon has some advantages from a humanistic point of view; it has deep cultural roots which cannot, should not, and need not be cut off.

The process of European co-operation and partial integration was greatly stimulated by the European Recovery Program (Marshall Plan), which with unprecedented farsightedness and generosity first helped the war-stricken countries to gather momentum in their efforts at economic reconstruction and development. It is an example of the type of approach now needed in other fields.

The appeal of a big market was mainly responsible for the efforts made by the Organization for European Economic Co-operation (OEEC) and the European Payments Union (EPU) to reduce the trade and payment barriers built up during the war. Quotas were

7. The prewar activity of the so-called "Oslo states" may be cited in this connection.

abolished and payments facilities broadened. This latter move helped to re-establish the multilateral character of European trade and production. However, liberalization occurred only with regard to quantitative restrictions; it did not include import duties. In this respect the small-scale experiments of the Benelux countries and the European Coal and Steel Community (ECSC) were pioneering efforts. Later the Rome Treaty laid the basis for a customs union among the six countries of the European Economic Community (EEC). This is to take shape over some twelve years, starting in 1958.[8] Actually, the Rome Treaty envisions more than a customs union; the intent is to create an economic union with several elements of positive integration, i.e., supranational agencies and common policies. While other factors are undoubtedly involved, it is significant that the countries participating in this scheme have experienced an unprecedented rate of economic growth. Since the reconstruction period, the annual rise in real income in the region has been some 5 per cent per annum.

Although the changes under way are rapid and remarkable from a historical point of view, against the background of the needs of our times they are less impressive. The fear of commitment is at work at many spots and in many minds. It holds up a really forceful integration of Europe's economies and, even more, of its political units. The only way to make Western Europe really strong is to create supranational agencies for tasks which technically can best be carried out at a European level. Agencies such as the Coal and Steel Community, the European Defense Community, the European Economic Community, and Euratom have been opposed by forces of an irrational nationalist or isolationist character, which are not even culturally significant. The only issue involved is a somewhat egoistic desire not to bind one's hands. This attitude has been particularly strong in the United Kingdom and the Commonwealth, areas well known for their preference for very loose forms of co-

8. The progress made since 1958 is illustrated by the following figures, expressing internal tariffs between EEC member countries on January 1, 1962 as a percentage of the initial level: industrial products, 60; nonliberalized agrarian products, 65; liberalized agrarian products, 70.

operation. It is cause for great satisfaction that the United Kingdom has now applied for membership in the Common Market.

The attitude just criticized is by no means restricted to British politicians and British public opinion. In France forces are at work which may damage the true interests of that country and of Europe, forces which have been well described by Lüthy.[9] One may contend that the signatories to the Rome Treaty have sometimes given in to conservative forces, as in the financial and monetary sectors (see Chapter 9). But the construction they accepted is far superior to the inconsistent structure of a free-trade area with its red tape as to the origin of commodities, and it is much closer to what an objective analysis of the requirements of the situation would show to be necessary in the interest of maximum efficiency.

The slowness of the negotiations centering around European unity, especially those concerning the interests of third countries, has given rise to some apprehension in the countries most affected by European integration. Two groups of countries are involved: those having a large volume of trade with the European Economic Community and those competing in export markets against the privileged associated territories. The outside world as a whole will hardly be affected by the establishment of the EEC since average import duties have not been increased.[10] A temporary decline in the competitive position of outside producers can be expected; prices of EEC products may become lower, but the resulting disequilibrium in the balance of payments of the EEC with the rest of the world will eventually eliminate this differential. The process of adjustment may be helped by the measures of "social harmonization" (increase in women's wages, overtime payments) required by the Rome Treaty.

There will, however, be cases – mostly industrial – where product prices will not return to their former level. They will settle at

9. H. Lüthy, *A l'heure de son clocher – Essai sur la France,* Calman-Lévy, Paris, 1955.

10. J. Tinbergen and associates, "The Impact of the European Economic Community on Third Countries," in *Sciences humaines et intégration européenne,* A. W. Sijthoff, Leiden, 1960, pp. 386 ff.

Table 3–1

OVER-ALL INCIDENCE OF TARIFF DISCRIMINATION
BY THE EEC AGAINST CERTAIN OUTSIDE COUNTRIES
(discrimination as a percentage of the total value of exports of the outside country)

Australia	0.03	Iraq	0.26
Austria	1.52	Liberia	0.00
Brazil	0.73	New Zealand	0.13
Burma	0.07	Nicaragua	0.39
Ceylon	0.21	Pakistan	0.00
Colombia	0.59	Portugal	0.50
Costa Rica	1.38	Salvador	0.88
Cuba	2.82	Saudi Arabia	0.00
Dominican Republic	3.52	Spain	1.49
Ecuador	1.47	Thailand	0.08
Greece	1.89	Turkey	1.19
Guatemala	0.50	United Arab Republic	0.11
Honduras	0.60	Uruguay	0.08
Iceland	0.80	Yugoslavia	0.88
Iran	1.12		

Note: By tariff discrimination the authors mean the difference between the tariff paid by the country considered and the average tariff paid by all importers. Among the latter the imports from other EEC countries are included; since no tariff is paid on these imports, the average tariff is always lower than the tariff paid by outside countries.

Source: J. Tinbergen and associates, "The Impact of the European Economic Community on Third Countries," in *Sciences humaines et intégration européenne,* A. W. Sijthoff, Leiden, 1960, p. 393.

a lower level,[11] and competing outside countries will have to adapt themselves to this condition. This is one way in which consumers in the outside world will profit from the increase in productivity brought about by European integration. At the same time the higher level of economic activity in EEC countries will create a greater demand for imports, especially since the EEC region is highly dependent on foreign sources for many of its industrial inputs.

11. In contrast some underdeveloped countries fear price increases, because of decreased competition as a result of the formation of EEC cartels. Whether or not this fear is justified will depend on EEC antitrust policy.

Even though the outside world as a whole may not be unfavorably affected by the establishment of the EEC, some individual countries will suffer. This is true of those countries that supplied relatively more commodities to the low-tariff constituents of the EEC like Benelux than to the high-tariff members like France. The equalization of duties damages them more in their Benelux exports than it helps them in their exports to France. It is also true that the structure of the EEC implies discriminatory treatment of outside countries, a policy which is indefensible even though grounded in the past. An over-all picture of the discrimination implied in the tariff structure is given in Table 3–1.

3.4 ECLA LEADS THE WAY

The tensions created by European integration are understandable. They should not, however, lead to any retreat, for the creation of bigger economic and political units will contribute to the well-being of the world as a whole. There are two positive and constructive developments one must hope for: a reduction in the outer tariffs of EEC, and similar acts of integration in other parts of the world. This topic will be discussed more fully in Part II of this study. Here we will merely recount the current status of efforts to integrate elsewhere in the world.

A remarkable example of continental thinking has been given by the Economic Commission for Latin America and its (former) Executive Secretary, Raúl Prebisch. ECLA has been a leader among the international agencies in the field of pure research: it was the first to apply comprehensive input-output analysis to countries and linear programming to industries of the continent. In suggesting development plans and policies ECLA has been more advanced and more courageous than any other international agency, even though the suggestions made by GATT have been more acceptable politically. Because of Latin America's cultural and economic solidarity some progress toward political integration has also been possible, although, as in Europe, vested interests have reacted adversely and governments have been loath to commit themselves. A long distance will have to be covered before substantial results can be obtained. Yet a beginning has been made in the co-operation of the five Central American states and in shaping a Free-Trade Area in Latin America as a whole.

The main tensions in Latin America today may be summarized under the following categories:

(i) in general the desire for rapid development stands in contrast to the slow expansion of world markets for primary goods; thus it creates balance of payments difficulties and the phenomenon of inflation;

(ii) the difference in the economic development of the United States and Latin America has given rise to economic ties which sometimes have political overtones: the Latin American countries, and especially Cuba, have rejected the hegemony of the United States, but Latin America regards the United States as an obvious source of financial assistance;

(iii) Europe's association with overseas territories tends to accentuate a certain discrimination against Latin American products, e.g., coffee, cocoa, bananas, meat;

(iv) within the continent there is some difference in attitude toward co-operation; the biggest country, Brazil, is inclined to go its own way while the other nations are more inclined toward a common policy.

It is only to be expected that in the remaining regions of the world – in Asia (including Australia, which cannot be considered a region by itself) and Africa – integration would be in a less advanced stage. Since many countries in these areas only recently became politically independent, they are not yet ready to consider giving up a measure of their national autonomy.

This is not to say that co-operation is unknown. In the Arab region it exists to a modest extent in the Arab League. This had initially a political and a defensive character, and thus it has a Joint Defence Council and a Permanent Military Commission. But there is also an Economic Council and some economic achievements can be recorded. Import duties on agrarian products have been abolished between most of the members, and the tariff on a number of industrial articles has been reduced (25 per cent to 60 per cent below the general tariff). This liberalization was meant to pave the way to a customs union, but import license requirements substantially mitigate the influence of the tariff reductions.

Some years ago the League members agreed upon the formation of an Arab Development Bank ("Arab Financial Institution for Economic Development") with a capital of 25 million Egyptian pounds. This bank will have many features in common with the IBRD. Recently agreement was achieved on the countries' capital participations and the institution is now being set up. After the United Arab Republic, Kuwait will be the largest single contributor. It is hoped that the Bank may lead to further investments in the region for development purposes by the oil-producing members of the Arab League (see Appendix II, p. 213).

The League has organized regular Arab Oil Conferences ever since 1959. Representatives of other oil-producing countries and of oil companies are invited to these congresses.

The Arab League has been active in the cultural field too. The Institute of Advanced Arab Studies, the Centre of Registration of Arab Publications, and the Cultural Museum, all in Cairo, attest to this fact.

The formation of EEC appears to have stimulated attempts at economic co-operation in Arabia. In all of the Arab countries studies have been made as to how this co-operation can be expanded. At the same time it is realized that there will be many political and institutional roadblocks; the tendency to domination by the United Arab Republic is a case in point. There is a great difference of opinion concerning the length of time it will take to achieve far-reaching economic co-operation in the Arab region.

In Africa the economic desirability of some form of co-operation is clear enough. European integration might bring about some disintegration in this area because countries linked to the EEC by economic ties are in a somewhat privileged position in comparison with other African nations and trade between these two groups may be less than optimal. As far as the countries formerly or still in the Commonwealth are concerned, some solution to this problem will soon emerge, as will be seen in Chapter 8. The situation in Africa changes so rapidly that it is difficult to pin down the causes of tension. However, it is worth noting that many of these new countries are so politically conscious that economic interests are often subordinated to political ends. This can be illustrated by the controversy between two important groups of African countries, the Casablanca Group and the Monrovia Group. Mali, the principal hinterland of Senegal, is a member of the Casablanca Group, while Senegal is a member of the Monrovia Group. This difference in political orientation has led to the official disruption of economic relations. Ghana's economic policy is to improve the trade position of Upper Volta vis-à-vis the Republic of the Ivory Coast, because the Ivory Coast belongs to the Monrovia Group while Upper Volta is a potential member of the Casablanca Group to which Ghana belongs.

Similar problems exist in Asia, where political issues have also done damage to the cause of economic co-operation. Many political obstacles must be overcome before co-operation can materialize. The greatest of these is apparently the contrast between the Communist and the non-Communist nations of the region. Even in the long run, there seems to be little hope for close co-operation — on a voluntary basis — between these two groups. The schism between the uncommitted and the pro-Western countries, and antagonisms caused by more down-to-earth matters, such as boundary disputes and personal relationships among political leaders, are other sources of trouble.

The Asian countries also face difficult problems in the economic field. Most of these stem from differences in development level and competitive strength. In this respect Asia is certainly less homogeneous than Africa. Some countries already have a fairly well developed industrial sector; Japan is essentially an industrial country. The least advanced economies are afraid of the more developed ones, and any co-operative scheme must take this into account. Also, because several countries have at present no foreign trade problems or balance of payments difficulties, they are not particularly interested in plans to expand intraregional trade — a clear case of myopia in the underdeveloped world.

Instances of successful regional co-operation exist, but most are limited in the nature of the activities co-ordinated and the geographical scope of the arrangement. Familiar cases are the lower Mekong River development scheme — in which Cambodia, Laos, Thailand, and southern Viet-Nam participate — and the Indus Valley project, a joint undertaking of India and Pakistan. In recent years the ECAFE Secretariat has increased its activities in the field of regional collaboration, and has made more attempts to strengthen economic co-operation among its member states.

Among the more ambitious co-operative schemes, the plans for deepening and widening economic co-operation between the Asian Commonwealth countries would seem to be the most realistic, especially as trade between them is already given preferential treatment. India is the great sponsor of this idea. On a more modest geographical scale the Federation of Malaya and Singapore want to integrate their economies and to extend this co-operation to Greater Malaysia, which includes some smaller Borneo territories. Outside the Commonwealth sphere, another co-operative group must be mentioned: the Association of Southeast Asia. This newly established association is made up of Thailand, the Philippines, and (again) the Federation of Malaya. So far, only a very loose form of co-operation is envisioned.

3.5 A SURVEY OF TODAY'S TRADE STRUCTURE

It seems desirable to find out, with the aid of objective criteria, in what respects today's pattern of international trade deviates from the most desirable quantitative structure: between which pairs of countries do we actually find much less trade than an optimum division of labor would suggest?

Data on duties and quantitative restrictions do not by themselves provide an answer to this question. The effect of duties and restrictions on trade must be determined. In principle this quantity should be measured by comparing actual trade flows with those which would occur in an optimal situation. Quantitative restrictions may be harmless if they permit a volume of trade not much lower than normal. The effect of duties depends on the price elasticity of demand for the goods concerned, and the same duty level may have different consequences for different commodities. The imposition of a uniform level of duties may simply lead to an adjustment of the country's exchange rate; it need not reduce the volume of trade at all.

The optimum pattern of trade can be defined in various ways. If all of the conditions enumerated in section 3.1 are fulfilled, optimum trade will be identical with free trade. Otherwise it may differ from free trade in ways not easy to estimate.

The problem has a micro and a macroversion: it may be posed for individual goods or for trade as a whole. The microversion would require many difficult operations; the macroversion seems more practicable, and at the same time more pertinent. The macroversion of the problem entails estimating the optimum volume of total trade between any two trade partners. The most practical way to do this is to assume that this figure depends on a few general characteristics of the countries considered, and to estimate the numerical parameters of this relationship from actual trade figures. This implies that trade between most of the pairs of countries is not restricted and can therefore be considered as an indication of the most desirable volume of trade. Alternatively, the relationship can be estimated on the basis of the trade figures between selected pairs of countries which apply no restrictions.

On the basis of earlier and more detailed empirical studies[12] as well as theoretical analysis, it was concluded that the most significant determinants of optimum trade were the size of the two countries forming each pair, and their geographic separation. The measure chosen to represent size was gross national product. The size of the receiving country plays a twofold role: it is an indication of the country's general volume of demand and also of its degree of diver-

12. Conducted by Mr. G. J. Aeyelts Averink, at the Netherlands Economic Institute.

sity of production. For this reason one should expect the influence of size to be less than proportionate: the greater a country's diversification, the less its need for imports. The size of the supplying country is an indication of its capacity to provide goods for export. Geographic separation is relevant for the obvious reason that it costs to move goods from one place to another. Since this cost is higher the farther the goods have to travel, distance must be expected to have a negative effect on imports. In the tradition of economic research, the explanatory variables have been assumed to influence the volume of trade according to a constant-elasticity function.

In some of our calculations we used money incomes; in others, real incomes, i.e., money incomes divided by a price index. It will be seen that this distinction had little effect on the results.

Three sets of calculations were made: one using figures for 18 countries (i.e., 306 pairs), another using figures for 42 countries (1,722 pairs), and a third using figures for 28 countries (766 pairs). The results of the calculations are shown in Table 3–2. A more detailed account of the material used and the calculations made will be found in Appendix VI. Before summarizing the conclusions to be drawn from the results we will make a few prefatory remarks.

Figures pertaining to the balance of payments for services given in Table VI–10 of Appendix VI show that in the majority of the cases this item is far less than the difference between the actual trade and the calculated "ideal" trade. Moreover, most countries are either mainly exporters or mainly importers of services. Our main conclusions therefore will not be changed substantially by the neglect of service imports and exports, even though trade in services will change the picture for individual countries.

As will be set forth in more technical detail in Appendix VI, deviations between the actual trade and the calculated "theoretical" trade may be due to import and export restrictions in all of the countries concerned. Import restrictions will as a rule operate most intensively on the trade flow they are applied to, but there will be indirect repercussions on the imports of the affected exporter since that country must try to maintain equilibrium in its balance of

Table 3–2

DEVIATIONS FROM STANDARDIZED INTERNATIONAL TRADE FLOWS, FOR COUNTRIES HAVING A SMALLER VOLUME OF TRADE THAN EXPECTED
(deviation as a percentage of actual trade)

	DEVIATIONS OF EXPORTS, ACCORDING TO SEVEN CALCULATIONS							DEVIATIONS OF IMPORTS, ACCORDING TO SEVEN CALCULATIONS						
	A-1	B-1	B-2	B-3	B-4	B-5	C-2	A-1	B-1	B-2	B-3	B-4	B-5	C-2
1. Argentina	...							...						
2. Brazil	–42							–46						
3. Chile	...						...	...						...
4. Cuba	...				–124	–66	...	...				–204	–150	...
5. Mexico	...							...						
6. Peru	...						...	...						...
7. Uruguay	...	–11	–28		–13		...	...						...
8. Venezuela							...					–60	–8	...
9. Belgian Congo	...						...	...						...
10. Ethiopia	...						...	...	–10	–8				...
11. Ghana	...							...						

12. Morocco	...						...	...						...
13. Nigeria	...							...						
14. S. Africa	–73							–9						
15. Sudan	...						...	...						...
16. Fr. W. Africa	...						...	...						...
17. Afghanistan	...							...	–5	–8	–25	–2	–19	
18. Ceylon	...							...						
19. India	...	–4	–8	–81	–42	–217	–6	...			–24		–121	
20. Indonesia	...							...	–33	–34	–34	–18	–19	
21. Japan	–144							–128						
22. Malaya	...							...						
23. Pakistan	...	–3	–18		–43	–159	...	...			–39	–10	–104	...
24. Philippines	...				–49	–9	...	...				–103	–59	...
25. Thailand	...							...						
26. UAR (Egypt)	...	–29	–23	–21	–9	–9		...						
27. Iran	...						...	...						...
28. Turkey	...	–27	–23	–21	–1	–8	–22	...						
29. Canada			–33	–23	–18	–40	–57		–13	–65	–62	–44	–78	–65
30. USA	–64	–40	–55	–81	–55	–73	–55	–43	–13	–28	–42	–21	–32	–76

Table 3–2 (continued)

	DEVIATIONS OF EXPORTS, ACCORDING TO SEVEN CALCULATIONS							DEVIATIONS OF IMPORTS, ACCORDING TO SEVEN CALCULATIONS						
	A-1	B-1	B-2	B-3	B-4	B-5	C-2	A-1	B-1	B-2	B-3	B-4	B-5	C-2
31. Austria	–35			–14		–2	–18	–41			–21		–8	
32. BLEU		–1	–11	–42	–85	–97	–23		–10	–23	–62	–102	–112	–27
33. Denmark														
34. France	–108	–102	–136	–119	–267	–80	–194	–95	–129	–160	–152	–296	–120	–150
35. Germany (Fed. Rep.)		–11	–27	–92	–93	–62	–11	–4	–44	–62	–139	–147	–101	–67
36. Italy	–79	–37	–49	–96	–113	–68	–82	–51	–23	–34	–75	–106	–49	–24
37. Netherlands				–26	–33	–78	–27				–37	–28	–64	
38. Norway	–24													
39. Sweden														
40. Switzerland	–2		–13				. . .	–2		–11				. . .
41. UK	–10	–25	–8	–65	–18	–109	–45	–4	–19	–4	–105	–10	–91	–36
42. Australia	–44							–68						

. . . means no figure available. A blank indicates a positive deviation. For further explanation see text and Appendix VI.

payments. Conversely, if we find that the imports of any country are below the theoretical value, the explanation may either be that this country applies restrictions or that the restrictions it experiences in its export markets indirectly influence the size of its imports.

Trade restrictions are most damaging when they prevent developing countries from importing a sufficient volume of the goods necessary for economic expansion. In this sense the negative deviations recorded for imports are more telling than those noted for exports. In cases where a "too" low level of imports is coupled with a "too" low level of exports, the deficiency must be ascribed mainly to the import restrictions of other countries. The typical "victim" of such import restrictions therefore must be characterized by too low figures on both sides of the trade balance.

The main conclusions to be derived from our inquiry may be summarized as follows:

First of all there emerges a normal pattern of trade; in all of our calculations we find a correlation coefficient of about 0.8 and fairly stable regression coefficients.[13] Roughly speaking, the standard pattern implies that the "normal" (or "theoretical," or "ideal") trade flow between any two countries will be proportional to the gross national products of these countries and inversely proportional to the distance between them. The first surprise is that the income of the importing country has a proportionate influence, notwithstanding the fact that some correlation might be expected between size and self-sufficiency. This seems to have a direct bearing on another surprise, namely that the only group of countries showing a consistently (and considerably) subnormal volume of trade (on the import as well as the export side) are the large industrial countries. This can only be ascribed to the restrictive practices of these countries or to their greater diversity of production, but the latter apparently is not so highly correlated with gross national product as we had expected. In fact, for 28 countries where a concentration

13. The correlation coefficient is a measure of the degree of similarity in the movements of two sets of figures. Completely parallel movement is reflected in a value of +1, completely opposite movement in a coefficient of –1; a zero value indicates absence of similarity.

coefficient for exports — which may be considered a crude indication of a country's "lack of diversity" — was available, the correlation between that concentration coefficient and gross national product amounted to only 0.54.

Our main result stands at variance with the belief that there is more trade between industrial countries than between nonindustrial countries. To be sure, this notion is correct in an absolute sense, but it is not correct if proportionality with gross national product is taken as a criterion of the normative level of such trade. Among the big industrial countries it is interesting to note that France — and to some extent the Belgo-Luxembourg Economic Union — is more restrictive and the United States less restrictive than the average. The smaller industrial countries including Japan do not show marked deviations from the theoretical norm; this implies that Japan is not a victim of the import restrictions of others.

We do not find clear examples of trade victims among the developing countries either. It is true that India, Pakistan, the United Arab Republic, and Turkey show a negative deviation on the export side (less exports than expected theoretically) in at least four calculations, but in some instances the deviation is barely significant. Pakistan shows a negative deviation on the import side in three calculations, India in two calculations. Afghanistan and Indonesia show subnormal imports in at least three cases, but they do not show subnormal exports — which may mean that it is their own autonomous restrictions which are at issue. Several other countries — Cuba, Venezuela, Ethiopia, and the Philippines — show too low imports in two cases. The only clear-cut cases where import restrictions reduced purchasing power are therefore Pakistan and, possibly, India.

It is clear that more research will be needed before firmer conclusions can be drawn. For what our conclusions may be worth, it follows that trade policies should not be overemphasized as an instrument in development; thus, we do not think the slogan "Trade, not aid" a proper guide to action.

CHAPTER 4

DAMPING THE WAVES

4.1 THE GREAT DEPRESSION, KEYNES, AND TODAY'S CYCLES

The environment in which developing countries have to conduct their affairs is affected by a number of political decisions pertaining to stabilization as well as by trade policy. Most but not all of these decisions are made by the big countries of the West. They center around two main objectives, nowadays generally recognized as desirable: the stabilization of general demand, and the stabilization of the prices of certain key primary products. In this context, stabilization means the avoidance of cyclical variations; it does not encompass the elimination of secular trend or seasonal pattern.

In this section methods of stabilizing general demand, usually described as anticyclical policies, will be discussed. Our approach to economic cycles has changed drastically during recent decades.

It was the tragedy of the thirties that many economists and politicians failed to understand the mechanism of cycles. One general misunderstanding was the idea that cycles were unavoidable. This probably arose because cycles had persisted for over a century; it was reinforced by a strong belief in laissez faire. Since the great depression, which greatly stimulated economic thinking, economists have isolated the main factors involved and traced their relationship. It is now clear that there exist instruments of economic policy that can be used to damp strong fluctuations in total demand, and to avoid the cumulative effects of disturbances which are unavoidable in a dynamic society. It is also apparent that while there is scope for government action in this field, government can be given a well-defined and limited task; there is no reason for business to fear large-scale intervention. The instrumentality is mainly public finance, and the method is to make compensatory changes in net public demand, i.e., government expenditures minus taxes.[1]

Of course, problems remain, but they cannot be compared with those that existed during the great depression. Then the role of government was imperfectly understood, and mistakes were made. Too much importance was attached to the restoration of "confidence" as a factor making for investment demand. Building faith in the government's fiscal position was thought to be the key to recovery. Public expenditures were reduced in the erroneous belief that the solvency of the state depended upon a balanced budget. However, the decline in public spending undermined confidence in the future because of its direct impact on demand.

As long as the forces making for cycles were poorly understood, governments resorted to regulation of the markets for single products strongly affected by the decrease in demand. Such regulation was highly esteemed and ironically some business groups willingly gave up more freedom of action than was actually necessary. A more stable flow of total demand, to be obtained with the aid of general anticyclical policies, will make future stabilization arrangements less complicated.

1. A more sophisticated approach would take into account the fact that the multipliers for expenditures and for taxes are not equal and that hence it is not strictly the difference between the two that matters.

John Maynard Keynes was without doubt the greatest single contributor to our knowledge of the nature of cycles. Granted that not all his arguments were accurately presented and his method sometimes stimulated the adoption of inappropriate policies, and that many other economists have made important contributions to our understanding of cycles, the vision of Lord Keynes and the terms he coined in order to popularize his views left a decisive imprint on modern theory.

In the present connection the most important lesson to be learned from the unhappy thirties is the failure of nationalism in economic policies. Much damage was done by policies which sought to enhance one nation's interest at the expense of others. This was true of trade restrictions and devaluations, both applied frequently and intensively in that period. These measures were designed to alter the balance of trade in favor of certain countries rather than to improve the position of the world at large.

On the whole the lessons of the thirties have been understood by economists and politicians. The anticyclical policies embraced by governments today differ widely from those of the thirties. Deficit spending was then considered a major sin; it is now accepted as a natural means of combating depression. It must be admitted that politicians do not always reject deficit spending in boom conditions as strongly as they should, and that the problem of creeping inflation is partly due to this attitude. One must hope that the proper discipline and flexibility will eventually develop in this field, but it should never be forgotten that unemployment is much worse than overemployment or inflation since it places a heavy burden on the economically weakest segment of the population.

The proper anticyclical policies are also the first line of defense against price instability in primary markets — a main problem for developing countries. It is significant that these policies are now accepted in the developed countries. Certainly our changed attitude toward stabilization is one of the reasons why we have been relatively free of cycles since the end of World War II. It is worth noting that in a period of equal length after World War I two major depressions occurred. The argument that our recent stability is simply the consequence of favorable long cycles, and that the danger has not vanished, is not convincing, for the instruments which have been used successfully to compensate for minor cycles can be used just as well in the event of any longer-term decline in private investment. We are now much better equipped to face setbacks. If private investment should weaken as a result of some saturation of the motor car or television markets, or as a result of a reduced need for reinvestment, or lower armament expenditures, our annual analysis would make it possible to apply compensatory measures which would keep total demand at its trend value. There is nothing mysterious about such a policy; therefore it need not affect confidence in the future. This is certainly one of the advantages of commodity flow analyses and central plans.

Policy-makers in the trade and monetary sphere also benefited from the lessons of the thirties. It is largely because of this that the IMF policy of prohibiting competitive devaluation and co-operative bans on trade policy weapons have been widely accepted.

4.2 THE NEED FOR A DOUBLE LOCK ON COMMODITY MARKETS

As noted above, better anticyclical policies of a general character will reduce the wide price fluctuations characteristic of primary markets by stabilizing demand. The main reason for the excessive disorganization of these markets in the thirties – prices fell to about one-third in many of them and huge stocks accumulated in others – was doubtless a failure of demand. But other factors also contribute to the instability of individual markets. The following may be mentioned:

(i) variations in crop yields are considerable and random, i.e., they are unpredictable a year ahead;

(ii) since the production processes of many primary commodities (coffee, rubber, cattle, pigs, and in a way all crops) require a considerable length of time, varying from six months to more than seven years, supplies cannot be rapidly accommodated to changes in demand;

(iii) the elasticities of demand and supply are often low;

(iv) several primary products are objects of speculation, a phenomenon that sometimes accentuates price movements.[2]

The need for special measures to stabilize price formation in primary markets has been widely felt, and a number of proposals have been made. Even though action is not as urgent as it was in the thirties, there are important reasons to provide primary markets with a "second lock," just as engineers are accustomed to work with safety factors of two or three. Indeed, the regular and orderly development of many countries depends so much on primary markets that their stabilization — within reasonable limits — is an important aspect of development policies.[3]

More stability may be obtained in a variety of ways, each of them beset by difficulties. Simple price setting will not work as a rule; it must be supplemented by quantitative regulations. Regulations on the demand side include rationing in times of scarcity and an obligation to buy more than would otherwise be the case in times of abundance. Such a program can be enforced with the co-operation of government agencies, but it has clear limitations.

Regulations on the supply side may be applied either in the sphere of trade, mostly foreign trade, or in that of production. In times of abundance supplies in trade can be restricted by stock accumulation on the part of a public or private organization. When not backed by restrictions in production such a program may soon lead to heavy financial burdens. The regulation of production requires more elaborate organization since it depends on the co-operation of individual producers, who usually are very numerous. Measures to enlarge supply in times of scarcity include subsidies of many kinds, commitments to purchase a certain quantity of a certain product, and obligations to produce certain minimum quantities; they have either financial or psychological drawbacks.

All of the measures mentioned may be applied to a market as a

2. See H. Rijken van Olst, *Prijsstabiliteit en speculatie* (unpublished doctoral thesis), Netherlands School of Economics, Rotterdam, 1948.

3. This is illustrated by the fact that a 10 per cent decline in the value of the exports of less developed countries offsets all aid received. See H. W. Singer, "Trends in Economic Thought on Underdevelopment," *Social Research,* Winter 1961.

whole or to only a portion of it, for example, to some of the large supplying countries. Practically, they have to be international in scope; they require the agreement of a number of governments on certain specific quantities, i.e., the level of prices or the volume of demand or supply. Such agreement is difficult to obtain since governments often have conflicting interests.

Occasionally, control is so centralized that agreement between governments is unnecessary. One case is that in which one country supplies a sufficiently large part of the total supply to enable it to dominate the market. A traditional example is that of Brazil and the coffee market; a less important one is that of Indonesia and the kapok market. Such situations are rare nowadays, but there is another possibility. If a single agency has the financial means to buy all the temporary surpluses that may develop, it can, by well-devised speculation, stabilize the market by itself.

Each kind of regulation has been applied recently, and some of the results will be discussed briefly in the next section.

4.3 THE FEAR OF COMMITMENT: POSTWAR MUDDLING

In general, the progress made in the field of international commodity agreements since the war has been disappointing, the more so since the world should have benefited from prewar experience in this area. The almost fatal price instability of a large number of primary international commodities during the period 1901 to 1951 has been documented by the United Nations.[4]

Perhaps the circumstances after the Second World War have been less pressing; among other things, anticyclical policy in several countries has had a stabilizing effect, and demand has only occasionally slackened. But uncertainty continues to plague international trade in primary products, mainly because of the factors mentioned in section 4.2. Therefore governments might have been

4. *Instability in Export Markets of Underdeveloped Countries,* United Nations, New York, 1952 (Sales no.: 1952. II.A.1.).

expected to show more alertness and co-operation in negotiating and implementing new commodity agreements. However, negotiations have often been lengthy and abortive because of the fear of commitment. Short-term national interests have prevailed. In a rising market sellers have not been interested, in a falling market buyers have not been interested, and few countries have shown interest in markets in which they were not immediately engaged.

One might attribute shortsightedness and irresponsibility to many of the governments concerned. Yet it must be admitted — especially in the case of agreements where both importing and exporting countries are represented — that there are quite understandable impediments to progress. Countries may hesitate to commit themselves because of the complexity of the subject. They may fear that a lack of balance between producing and consuming countries will weaken the force of the agreement. Such fears have sometimes proved to be justified, as in the case of the Wheat Agreement where, as will be shown, exporting countries increased their export prices to such a high level that they impaired the Agreement's flexibility. Countries that are very susceptible to outside competition are most concerned about the number of prospective signatories to an agreement. An agreement may serve the interest of an exporting country that is strongly dependent on a single commodity, but there are many cases in which a country's import and export interests conflict. Compromise solutions may be difficult to arrive at unless the agreement is extended to a range of commodities, a move which would give rise to more complicated and costly administrative arrangements. The number of single-commodity agreements could be extended, but not all commodities are adaptable to this purpose and, again, this would involve higher costs. Then there is uncertainty as to the actual influence on prices and incomes of the regulations contemplated in the agreement. Finally, there are technical problems — centralized or decentralized storage, the capacity of the storage facilities, financing methods, etc. — which are not always easy to solve. All these factors explain why it is often very difficult to come to an agreement. Yet they do not provide sufficient justification for a fear of commitment.

4.4 A BRIEF SURVEY OF IMPORTANT COMMODITY MARKETS

The commodity agreements in operation are the Wheat Agreement, the Sugar Agreement, the Tin Agreement, and the Coffee Agreement. We will discuss these pacts briefly in the light of the problems mentioned above and then consider the prospects for agreements in other areas.

In their study *Trends in International Trade,* a panel of experts[5] gave considerable attention to international commodity agreements and found that there were three methods of implementation in general use. Thus the Wheat Agreement is mainly based on the principle of the multilateral long-term contract, the Sugar Agreement and the Coffee Agreement on the principle of quota restrictions on exports, and the Tin Agreement on the buffer stock principle.

The International Wheat Agreement

Wheat is the most important internationally traded agricultural commodity. Changes in the wheat market have repercussions on the world markets for most staple products. The International Wheat Agreement attempts to stabilize world grain markets by assuring wheat supplies to importing countries and markets for wheat to exporting countries at equitable and stable prices. The Agreement came into being in 1949 after long negotiations; it was revised in 1953, 1956, and 1959. In 1956 the participating exporting countries were Argentina, Australia, Canada, France, Sweden, and the United States; participating importing member countries numbered 44. In 1959 Italy, Mexico, and Spain joined the exporting countries. The United Kingdom refrained from participation until 1958 because she was opposed to the onesided price fixing of Canada and the United States, which resulted in high prices and surplus stocks.

The terms of the Agreement are such that as long as prices on the international wheat market remain between a specified maximum and a minimum level (the former being about 30 per cent higher than the latter), trade is entirely free. If in a given year the free world market

5. *Trends in International Trade,* a Report by a Panel of Experts, GATT, Geneva, October 1958.

price exceeds the upper limit, exporting countries are obliged to sell a certain quantity of wheat (so-called guaranteed sales) at the maximum price to member importers in the same year. On the other hand, if world market prices fall below the lower limit, importing countries have to make "guaranteed purchases." Total guaranteed sales are equal to total guaranteed purchases. The Agreement is administered by the International Wheat Council, which was set up in 1942. The importing countries together hold the same number of votes as the exporting countries. Voting rights are distributed according to the quantities guaranteed. This means that the United States and Canada, the largest exporters, are in fact the administrators of the Agreement.

The results of the Wheat Agreement have been disappointing. In the period 1949–1953 free world market prices were so high that the Agreement's prices were at their maximum. After 1953 free world wheat prices decreased substantially but the Council's prices were maintained at a relatively high level despite accumulating world surpluses. In fact prices were fixed by the United States and Canada on the basis of national price regulations, through operations with local wheat stocks.[6] This situation still persists. The Wheat Agreement did not result in an elimination or reduction of national price regulations for wheat. On the contrary, the international price structure of wheat has been greatly disturbed by government interference in all important wheat-producing countries.

The 1959 agreement is somewhat more flexible than the original agreement. Importing countries guarantee to buy not fixed quantities but a percentage of their total wheat imports. In order to give more attention to the surplus problem, and perhaps in order to counteract the price regulations of the United States and Canada, the United Kingdom joined the Agreement. This is an obvious gain in coverage. But although the participating countries account for about 85 per cent of the world's wheat trade, only half of the world trade is subject to the rules of the Agreement, for the rules apply only to commercial transactions between member countries; "special transactions" such as bilateral agreements, credit and barter arrangements, and gifts are excluded. So far there is no indication that the Agreement has contributed to the substitution of multilateral for bilateral trade; the latter is on the whole even preferred by the participating countries.

6. The fact that the governments of these exporting countries are in a position to control the world price of wheat by local stock manipulations and other means would make it difficult to apply the international buffer stock principle to wheat (see *Trends in International Trade*, p. 76).

Serious concern for the future is expressed in a report of an FAO Committee on Commodity Problems.[7] The report states that the world grain situation is characterized by an imbalance between supply and consumption. It further observes that the situation is most serious with regard to wheat, although increasing concern is felt over coarse grains. The rise in consumption is not keeping pace with the rise in production, so that stocks continue to pile up. Wheat prices have been fairly stable, but prices of coarse grains have shown a downward trend. A need for more effective international co-ordination of governmental action is apparent.

The United Nations Wheat Conference met in January 1962 to discuss the content of a new agreement, as the present one expires on August 1, 1962. Apart from a number of technical and administrative matters, attention was focused on the problem of exporting surplus wheat to underdeveloped countries without disturbing the normal commercial trade. It is hoped that more countries will participate and submit to the regulations of the Agreement.

The International Sugar Agreement

The International Sugar Agreement uses quota restrictions on exports to regulate the volume of trade in the free market, i.e., that segment of the world not covered by special trading arrangements. It seeks to stabilize world sugar prices within a given range by adjusting the quotas granted to exporting countries.

The first agreement was concluded in 1937; it was ratified by 21 countries and covered a period of five years. In 1942 the commercial rules of the Agreement were suspended as a consequence of the war. The International Sugar Council remained active and made a sustained effort to draft a new agreement. This agreement came into force on January 1, 1954. The present International Sugar Agreement which became effective on January 1, 1959 is a continuation of it and also runs for five years. There are 44 members: 18 importing countries and 26 exporting countries. The general objectives of the Agreement are: to assure supplies of sugar at stable prices which are acceptable to consumers and producers alike; to increase the consumption of sugar; and, by providing adequate returns to producers, to maintain the purchasing power of countries and areas which are dependent upon the production or export of sugar. It is recognized that a fair return is also desirable so that fair wages and decent working conditions can be maintained.

The world sugar market is characterized by preferential blocs. A

7. *Report of the Thirty-fourth Session of the Committee on Commodity Problems to the Thirty-fifth Session of the Council of FAO,* Rome, 1961 (Doc. C 61/8).

large part of the world sugar trade takes place within the confines set by the preferential regulations of the United Kingdom, the United States, France, and Portugal. The rest of the world sugar market, about 40 per cent, is known as the "free market." Only this part falls under the jurisdiction of the Agreement.

The initial export quotas are based on yearly estimates of the needs of the participating importing countries. The Council can make new estimates before April 1st of each calendar year and change the quotas accordingly (the maximum reduction is 20 per cent). Exporting countries are expected to retain minimum stocks at the beginning of the crop year amounting to 12.5 per cent of their basic export tonnage. Members of the Commonwealth Sugar Agreement reserve a special stock for the free market. If the market price rises above a certain level (at present $3.75 per 100 lbs.), stocks must be reinforced. Exceptions are made for the British Commonwealth, the United States, the USSR, France, and Portugal. Basic export quotas are also set by the Council for the USSR, France, and Portugal. A combined export quota for the Commonwealth is fixed by the British Commonwealth Sugar Agreement. Estimates are made of the USSR exports.

There is a certain understanding and complementarity between the "free market" and the preferential blocs.[8] Thus, although the Sugar Agreement covers less than half the world sugar market, it has undoubtedly had a stabilizing effect.

Many serious problems remain nevertheless. Although consumption is rising, particularly in some low-income areas, the increase is slower than the increase in production.[9] Moreover, production during the last ten years increased most in importing countries, which means that international sugar trade has grown at a much slower rate than world production and consumption. There is also a tendency for individual importing countries to become more self-sufficient and even to become net exporters. All of these matters have the full attention of the International Sugar Council. In accordance with a decision of the 1961 UN Sugar Conference, and with a view to the preparation of a new Sugar Agreement, the Council is going to undertake an extensive study of the stock problem; it will also make recommendations designed to increase

8. This is probably one of the reasons why the Agreement has been fairly successful. With regard to quota arrangements in general, a panel of experts is of the opinion that "they are liable to break down unless the agreement covers virtually all exporters or unless the importing countries in the agreement take effective measures to limit their imports from outside countries." (See *Trends in International Trade*, pp. 75–76.)

9. See *FAO Commodity Review 1961,* Rome, 1961 (Doc. CCP 61/9, p. 61).

consumption, including non-human consumption. However, the Council has not yet succeeded in fixing new basic export quotas adapted to the radical change in the pattern of international sugar trade caused by the end of trade relations between the United States and Cuba.[10]

The International Sugar Agreement expires in 1963. It is hoped that the new agreement will cover a larger part of the sugar market[11] and be less complicated than its predecessor.

The International Tin Agreement

The most important producers of tin ore are the Federation of Malaya, Bolivia, Indonesia, Congo, Thailand, and Nigeria. These countries produce most of the world's tin excluding the Sino-Soviet area. There have always been problems in the tin market. Production costs vary widely and vested producing interests have often suffered as a result of severe competition from newcomers. On the demand side, there have been marked fluctuations in consumption due to cyclical movements, technical difficulties, and stock problems. Still greater swings have occurred in prices, even if we consider yearly averages.

From the beginning of the twenties until 1953, when the International Tin Agreement was concluded, several attempts were made to stabilize the world tin market (Bandung Pool, 1921; Tin Producers Association, 1929; in 1931 the International Tin Committee and an International Tin Pool; in 1935 a buffer stock). All were based on co-operation between producers only. When the London Metal Exchange reopened after the war, the price of tin showed excessive instability. This led to more intensive contacts and consultations between producers, but it was not until 1956 that the International Tin Agreement came into operation. The Tin Agreement, which was revised in 1961, is the third international raw material agreement to come under the auspices of the United Nations. The governing body is the International Tin Council.

The International Tin Agreement is the only commodity agreement which utilizes the principle of buffer stocks. The buffer stock is controlled by the Council. Producing countries contribute to it, a maximum of 75 per cent in tin metal and the rest in cash. The function of

10. The most striking development during the discussions on this subject was that Cuba, which lost about 3 million tons as a result of being shut out of the American preferential market, claimed a basic tonnage of 7.3 million tons for the free market, covering its original quota of 2.4 million tons and total deliveries of 4.9 million tons to the Communist countries.

11. South Africa relinquished its share in the Commonwealth combined export quota and obtained an independent quota in the free-market sector of the Agreement.

the buffer stock is to keep tin prices between certain limits. If the price of "cash" tin at the London Metal Exchange is equal to or higher than the upper limit (in 1961, £880 per ton, now £965), the Council must sell tin until the cash price is lower than the maximum price or until the buffer stock is exhausted. If the price of cash tin is lower than the minimum price (during 1961, £730, at present £790), the Buffer Stock Manager will try to purchase tin until the cash price is above the minimum or his money resources are exhausted. The Manager also has discretion to sell or to purchase if the price is approaching the upper or the lower limit, respectively. The Council can impose quota restrictions on exports if the buffer stock exceeds 10,000 tons (the maximum buffer stock is 25,000 tons) in order to maintain the price of tin metal within the set range. Its decisions are based on estimates of future demand, stocks, prices, and so on. The total export volume agreed upon is shared between the producing countries according to their percentage shares in total production.

The International Tin Agreement has no doubt contributed to price stability. It has done so without extensive government control, although the Manager has considerable authority to act. The system is regarded as workable even if not all producing and consuming countries are participants (it covers about 80 per cent of world production and about 50 per cent of world consumption, both excluding the USSR and Communist China). It would be gratifying if the United States and Germany, as major consuming countries, joined the Agreement. The United States reportedly is opposed to any extension of systems based on buffer stocks. According to recent information, however, it is prepared to discuss terms on which it might join the International Tin Agreement. The United States has built up an enormous strategic stockpile of tin, but it has announced that it will not disturb the market by selling large quantities of surplus metal.

That the present situation vis-à-vis the United States is unsatisfactory is indicated by recent developments. One of the problems of the Tin Council is the prompt adaptation of maximum and minimum prices to changes in supply and demand. The price of cash tin had risen to £830 per ton in April 1961; by June 1961 it was £880 per ton and the Manager's Buffer Stock was being exhausted. The tin price continued to rise, reaching £992 per ton in September 1961, a level in excess of the ceiling set by the Agreement. Export controls have been in abeyance since October 1960 but producing countries feel that the existing price range is unfair to the industry. Although their proposal to raise the floor and ceiling prices (to £800 and £1,000 respectively) has been rejected by the Council, the matter is still undecided. As long as there is uncertainty about the possibility of releasing tin from the United States stockpile in order to help regulate prices and as long as the Buffer Stock Manager has no tin to sell, the Council finds it impracticable to raise support prices. The present agreement expires on July 1, 1962. Producing countries have announced that they will withdraw from the Council and form a separate pool if their proposal is rejected again.

Behind all this muddling and horse-trading is the fact that market conditions have changed. A lag in production has been apparent for some time. No new fields have been found in the non-Communist world in recent decades so lower-grade deposits have to be explored despite the high initial costs. At the same time consumption is steadily increasing. International co-operation should be adapted to the new market situation.

The International Coffee Agreement

According to a study made by the Food and Agriculture Organization,[12] coffee production since 1930 falls into three distinct periods. The first (1930–1939) was characterized by slowly increasing production and the accumulation of surplus stocks; the second (1940–1947), by declining production; and the third (1947 to date), by rapidly expanding plantings stimulated by postwar price increases and, since 1957, the growth of massive surplus stocks.

The FAO notes that the pattern of world production changed considerably after 1947. During the 1947–1959 period production increased in Brazil by 84 per cent, in Colombia by 27 per cent, and in other Latin American countries by 66 per cent. At the same time production in Africa and the other continents increased by 150 per cent. The increase in tonnage in Brazil was, however, greater than that in all other coffee-growing countries combined. At present coffee is produced in over forty countries; Brazil accounts for about 50 per cent of world production, Colombia for some 15 per cent, and African producers for about 25 per cent.

During the period 1946–1949 prices rose due to increasing consumption and the reduction of stocks; it was a period of renewed planting. The 1950–1957 period saw unprecedented price increases, and a boom in coffee tree planting. Since 1958 there has been a period of adjustment and prices have declined. For the first time since the Second World War the coffee industry is faced with a serious problem of overproduction and stock accumulation caused by the maturation of trees in substantial quantities. World coffee consumption at present is at a record level and

12. *Bulletin No. 31,* FAO Commodity Series, Rome, 1959.

may increase still further, especially in the producing countries of Latin America. It is improbable, however, that the increasing supplies can be absorbed by consumers at prices acceptable to producers.

The increasing need for integrated programs for the improvement of the coffee industry has led to the establishment and strengthening of several multilateral bodies concerned with coffee in Latin America and Africa. In 1959 the International Coffee Agreement, combining Latin American and African producers, came into force; it was renewed in 1960, with only slight modifications, for a period of one year. There are 28 participating countries, accounting for over 90 per cent of world output. The Agreement is based on the principle of export quota regulations. According to the 1960 agreement, countries may choose between export quotas equal to the quantities shipped by them in their peak export year during the past ten years and quotas amounting to 88 per cent of their exportable production during one of the two years the Agreement has been in force. Brazil and Colombia have fixed quotas. Since world consumption continues to lag far behind production, the export restrictions of the Agreement are not sufficient to stabilize the market although they do prevent major price declines.

The International Coffee Study Group is now studying the possibility of a long-term world-wide Coffee Agreement between producing and consuming countries, with export quotas and a common policy toward stocks. The existence and even the extension of the regional organizations in Africa and Latin America dealing with coffee (for instance, the Inter-African Coffee Organisation, which was founded in December 1960 by six independent African countries, the United Kingdom, and Portugal, recently embraced closer co-operation with Brazil) does not affect the general support for such a long-term agreement. As a result of discussions in September 1961 a committee was set up by the Study Group to draft the text for a new agreement to be discussed at an intergovernmental meeting early in 1962. Meanwhile the existing International Coffee Agreement was renewed for another year. It is hoped that the new agreement will be signed by participating countries before the expiration of the present agreement on August 1, 1962.

The International Tea Agreement

During the past ten years there has been a divergence between the increase in tea production and the growth of international tea trade. Calculations by the FAO show that during this period production rose by 35 per cent and trade by 30 per cent. The gap, however, was filled by increasing consumption in the producing countries. As a result the international tea market is a stable one. Because of these benign circumstances the International Tea Agreement was not renewed in 1955 though the International Tea Committee was kept in being.

Probably the rate of increase of consumption in producing countries will be somewhat lower in the future. World production is expected to continue to increase at about the same rate. Sooner or later, therefore, a situation may develop which will call for a revival of the International Tea Agreement.

Cocoa

International governmental discussions are under way in order to arrive at an agreement to stabilize cocoa prices. One might wonder why an international agreement did not emerge earlier — especially in the fifties — since cocoa has long been subject to severe price fluctuations. One reason is that the fluctuations of the past were mainly due to sharp year-to-year variations in yield caused by weather conditions and the incidence of plant diseases. Another reason is that demand is virtually incalculable; there has been little uniformity of trend in the main consuming areas. Some producing countries have attempted unique solutions. Thus the Ghana Cocoa Marketing Board makes payments to producers which are not directly linked to export prices. However, most producing countries simply did not pay sufficient attention to the problem of long-term price stability.

In recent years the picture has changed. With the gradual perfecting of production methods, better control of diseases and pests, extension of planted areas, and the maturation of earlier plantings, world production has increased substantially. But since consumption has not kept pace, prices have declined and stocks have accumulated. Producing countries realize that continued low prices threaten their national economies. In October 1960 the FAO Cocoa Study Group set up a working party on price stabilization and one on the promotion of consumption. The first committee prepared a draft agreement to stabilize cocoa prices, which has been sent to the interested governments. The proposed agreement is based on the principle of export quota regulations.

Bananas

About 85 per cent of world output of bananas originates in Latin America. Outside of this region the Canary Islands and Africa are the main producers.[13] Production is strongly susceptible to fluctuations. Although statistics are inadequate, it is apparent that there has been a steady increase in production which is likely to continue in years to

13. See *FAO Commodity Review 1961*, pp. 104–105, and *International Trade 1960*, GATT, Geneva, 1961, p. 31.

come. World exports have increased accordingly; Ecuador's share in the total rose from 1.5 per cent before the war to 25 per cent in 1961. Major importing areas are North America and Western Europe. As a result of growing supplies from low-cost areas, especially Latin America, and increasing competition from other fresh fruit, banana prices have shown a downward tendency.

Although there seems to be no serious disequilibrium between supply and demand at present, the upward trend of production and the competition prevailing seem to warrant the establishment of more contacts between producing and consuming countries. However, although an International Meeting on Banana Production was organized by the FAO in 1960, it dealt only with technical and statistical matters. The Inter-American Banana Organization, which was established in August 1961, is not equipped to control production, trade, or prices, because no agreement was reached with regard to these matters.

Citrus Fruit

An international agreement for citrus fruit is under study. In 1961 the FAO Group on Citrus Fruit made a special investigation of the long-term prospects of these commodities. They found a distinct upward trend in world citrus fruit production in spite of setbacks due to unfavorable weather conditions and competition from other types of fruit. This will most probably be strengthened in the future because of new plantings during recent years and planned further expansion.[14]

It is generally recognized that consumption must be stimulated. Better-organized international co-operation is also felt to be necessary. In view of the complexity of the marketing problems to be expected in the near future as a result of production increases in individual countries, co-ordination of national policies is being studied. Attention is also being paid to the improvement of statistics, standardization, and quality control.

Olive Oil

As for olive oil, the initiative for an international conference was first taken by the FAO early in the fifties. In 1956 a conference was held, on the initiative of the United States, which led to an International Olive Oil Agreement. This covers a number of arrangements with regard to the stimulation of consumption, standardization, the preparation of market surveys, and so on. The Agreement was signed by 14 countries, and has been ratified by nearly all of them. No agreement

14. See *Report of the Fifth Session of the Committee on Commodity Problems*, p. 37; *FAO Commodity Review 1960*, p. 58, and *International Trade 1960*, p. 31.

has yet been reached on organizing the international olive oil market.

However, annual fluctuations in olive crops remain the principal matter for concern. In 1961 the International Olive Council set under way a study of an international price stabilization scheme, which would include financing of stocks. This study is now in progress.

Cotton

The outstanding fact about the international raw cotton market is that the United States is by far the world's largest exporter, accounting for about 40 per cent of world exports. The growth of world cotton trade depends on consumption in industrialized countries and, to a large extent, on import demand in developing countries. Cotton consumption has risen slowly during the last decades, and its role in total fiber consumption has decreased because of competition from rayon and synthetics. If cotton succeeds in remaining fairly competitive with other fibers it may maintain its relative market share.

The United States is the price leader in the raw cotton market. Its export policy ultimately determines world cotton prices. United States policy is characterized by a system of domestic support prices, acreage allotments, marketing quotas, stockpiling, and export subsidies. Admittedly, this system has helped to stabilize world cotton prices. But, being a high-cost producer, the United States has not only imposed relatively high prices on the importing countries, it has also created export and surplus-stock problems for itself. The International Cotton Advisory Committee, which was established at the end of the thirties, repeatedly tried to bring about an international cotton agreement. Many consuming countries took part in the discussions, but in 1954 the question was removed from the agenda. It was felt that no serious overproduction existed, and that United States agricultural policy was a stumbling block. The United States system of export subsidies was censured.

Over the years the Committee has been studying the world cotton economy, production and consumption trends, the exchange of technical information, the problem of cotton surpluses, and so on. Recently it has devoted much attention to the international repercussions of the United States cotton policy, and a study group has been established to look into this question.

Copper

The United States is the main copper-producing country and at the same time the main copper-importing country. The pattern of world trade is distinctly influenced by the fact that there are strong, decentralized but integrated companies, chiefly in the United States and Western Europe, that own mines in the exporting countries and refineries in the importing countries. World demand for copper is expected to increase considerably, mainly because of its use in the electrical engineering field, where technical considerations give it a strong competitive position.

Although there will be short-term changes in world supply-demand relations, which will vary from one area to another, it seems reasonable to assume that future demand will be able to keep pace with supply. In 1958 the UN Exploratory Meeting on Copper concluded that there was no need for further action. Since then no consultations at the governmental level have been initiated. Although there may be voluntary restrictions on production, there is no indication that an international long-term agreement will be effectuated in the foreseeable future. Because of the predominant position of a high-cost developed country and the typical structure of the copper market, the terms of an agreement would have to be most carefully studied.

Lead

The United States consumes about 40 per cent of free-world lead supplies, the United Kingdom about 17 per cent, and the EEC countries 25 per cent. The United States is also the biggest importer. The main exporters of ore and metal are Australia, Canada, Mexico, Morocco, Peru, and some Western European countries. The international trade pattern of lead is, again, partly determined by property rights. American, British, and French industrial concerns have interests in Peruvian, Mexican, Canadian, and African lead production.

The production of lead and zinc is often closely related, especially in Australia. Lead prices are below zinc prices, however, and the market prospects for lead are less favorable than those for zinc. In recent years lead prices have been depressed by a continuous oversupply, resulting in increasing stocks. In September 1960 the UN International Lead and Zinc Study Group decided to continue voluntary curtailments in market supplies. The result was unsatisfactory. In March 1961 the Study Group agreed on curtailments of mine and/or metal production by a number of producing countries. These reductions have not been put into effect, and world demand has continued to lag behind production. Meanwhile partial solutions have been considered. In the United States financial aid to the lead and zinc mining industry has been proposed and is a subject of discussion in Congress. Barter transactions between the United States and Canada and Australia have provided only temporary relief. There is of course general agreement as to the need to encourage consumption. Exports from the centrally planned countries are an uncertain factor, but this applies to most commodities.

Zinc

As is true of lead, zinc has end uses in which it is not substitutable, and others in which its position is less secure. But on the whole the prospects for zinc are better than those for lead. Zinc prices have been relatively stable, and consumption is developing satisfactorily. The stock position differs from that of lead in that zinc stocks are only excessive locally. The United States holds the largest part of world zinc stocks, but most American producers have brought about a reduction in surplus stocks. Although the situation is not entirely satisfactory, the International Lead and Zinc Study Group decided at its 1961 meeting that for the time being there was no reason to take action to reduce zinc supplies. The group felt, however, that long-term studies should be undertaken and that the search for new applications should be pushed. A working party has been established to go into these matters; it will also make inquiries into the possibility of intergovernmental agreements.

4.5 SOME ATTEMPTS AT SHORTCUTS

As should be clear from the preceding section, the road toward stabilization of commodity markets with the help of international agreements is not an easy one. A large number of organizational steps must be taken, and agreement is sometimes difficult to obtain. Many years of administrative work are involved. Experts and politicians have occasionally asked whether simpler solutions are not possible. One simpler solution has already been mentioned: a large buffer stock operated by a single agency. Three other proposals have been the subject of thorough discussion by expert groups established by the Secretary-General of the United Nations.

The first of these proposals was formulated in a report of 1949[15] in the context of a general anticyclical policy. Its purpose is to compensate countries that are unable to maintain their imports because of a decline in their export income. These countries would be entitled to draw the necessary currencies from the IMF. The

15. *National and International Measures for Full Employment,* United Nations, New York, 1949 (Sales no.: 1949, II.A.3). Members of the group were J. M. Clark (working in association with A. Smithies), N. Kaldor, P. Uri, E. R. Walker (chairman).

IMF would obtain these currencies from the countries whose imports had fallen in the first place if, and only if, the fall was a consequence of inadequate anticyclical policies on their part. The adequacy of anticyclical policies would be judged on the basis of employment figures.

The second proposal was formulated by a member of another group that published a report in 1953.[16] It was taken up again and unanimously accepted in a form worked out in a report of 1961.[17] The aim is roughly the same as that of the proposal just described. The means is an insurance scheme comparable to the unemployment insurance plans in industrial countries. A fund would be created which would be fed by contributions from all countries adhering to the scheme. These contributions would amount to a few tenths of 1 per cent of national income, or about 1 per cent of exports if all countries should participate. Benefits would be paid to member countries that experienced a decline in exports amounting to more than 2.5 per cent of the moving average of the three preceding years; they would cover the loss beyond this percentage to the extent of 50, 75, or 100 per cent. These figures have been so calculated as to leave a favorable balance in the fund for most years, a balance which could be invested in developing countries by the purchase of government bonds. Alternative setups are described in the report, and the characteristics of the benefits are flexible: they may be grants as well as loans.

The third proposal was put forward by the chairman of the second group, Professor Goudriaan. It may be summed up as a joint stabilization scheme for a number of raw materials by the monetization of these goods. It has been referred to as the raw material standard, and has also been advocated by Mr. Benjamin Graham.[18] The main idea is that a certain cocktail of raw material property

16. *Commodity Trade and Economic Development,* United Nations, New York, 1953 (Sales no.: 1954, II.B.1). Members of the group were C. F. Carter, Sumitro Djojohadikusumo, J. Goudriaan (chairman), K. Knorr, F. G. Olano.

17. *International Compensation for Fluctuations in Commodity Trade,* United Nations, New York, 1961 (Sales no.: 1961, II.D.3). Members of the group were I. H. Abdel Rahman, A. Carillo Flores, Sir John G. Crawford (chairman), A. G. Hart, S. Posthuma, M. L. Qureshi.

18. B. Graham, *Storage and Stability,* McGraw-Hill, New York, 1937.

rights (a set of fixed quantities of each of about twenty raw materials) would be accepted by a few of the main central banks as cover for their monetary circulation at a fixed price. Such raw material packages would be purchased by the banks whenever the joint free-market price of the commodities involved fell below the fixed price, and sold by the banks in the opposite case. The stock with the central bank would regulate joint supply and demand in such a way as to keep the average price (weighted according to the composition of the package) constant. Although this scheme would certainly stabilize the average position of all the primary producing countries, it does not exclude the possibility of serious difficulties in single markets.

The first and third of the proposals described have been criticized on technical points. No doubt many difficulties would have to be solved before any of them could be applied. Nevertheless, commodity agreements also present difficulties, and the situation that would exist in the absence of any co-operation would be even more troublesome. Before engaging in activities to stabilize more raw material markets, governments might do well to ask for a comparative study of the schemes presented.