CHAPTER II.

PRINCIPLES OF ECONOMIC INTEGRATION.

Section 1. The Traditional Theory of Integration.

Post-war reconstruction and changes in the level and structure of International Trade are marked by three trends - International Payments System (IMF, etc); Tariff Reductions (GATT & MFI); and Movement Towards Economic Integration (EEC etc.). We are here concerned with the last of them, because the division of the world into trading blocs has been a development of major significance that was hardly foreseen in 1945. It is therefore appropriate to consider what economic theory has to say about customs Union for 'the theory of customs Union' is the traditional title for the theory of Economic integration as it has been treated in the literature, which has concentrated on customs unions among the various possible results. The present understanding of the theoretical implications of such arrangements is based on the pioneer study of the subject by Professor Jacob Viner (USA). Equally associated with it are the names of M. Bye (France), K. Isser (Germany), and James Meade (U.K.). The issues involved were developed by Professor James Meade and others. The work of Viner, "The Customs Union Issue", is considered a classic which offers no undeserved appraisal to trade blocs. It is now customary for discussions of customs-union theory to start with a

1. The Customs Union Issue; Viner (1950); The Theory of Customs Unions; Meade (1956); and others.
salutation to Jacob Viner. We shall therefore discuss the traditional theory and the recent developments to it and further seek modifications of the theory as would be applicable to the conditions of the developing countries of South Asia with which we are intimately concerned. We shall also review the working (functioning, achievements and problems) of trading blocs of the developed and the developing countries to draw necessary lessons for application to the nascent grouping of South Asian countries which is a sub-region of the Asia to evolve a suitable arrangement of economic cooperation among them.

Ricardo's theory of comparative advantage showed that trade and therefore the removal of barriers to trade, could be to the advantage of each of two countries even if one of them had absolutely lower costs in the production of all commodities, provided that each country specialised in the production of the commodities in which it had a comparative advantage. Viner's theory of trade creation and trade diversion showed that the removal of barriers to trade between two countries could cause losses for one or both of the union partners if it resulted in the diversion of a partner's purchases from a low-cost outside source of supply to high-cost supplies from the other partner. The belief that customs unions generally or always increase welfare has been replaced by the sceptical doctrine that an increase in welfare is, in general, no more likely than a reduction. Viner even went so far as to state, "where the trade diverting effect is predominant, one at least of this member countries is bound to be injured, both may be injured, the two combined will suffer a net injury and there will be injury, to the outside world and to the world at large". The world at large will gain only in so
far as the trade-creating effect is predominant and the gains of the union partners therefore outweigh any losses of the outside world, within a customs union, exporters and importers gain from reduction in barriers to trade, while import-competing producers lose. (Lipsey pointed out that export-competing domestic consumers also lose). No single country need gain again from a customs union, however, and therefore no collectivity of countries need gain. But on other assumptions, however, either or both of the union partners may gain from the formation of the customs union; and, although the immediate effect on the outside world must be a loss of markets if its products are competitive with those of the union partners, this loss may be small and may be outweighed by such indirect effects as the growth of demand within the customs union for complementary products from outside. The customs union must gain if the gross profit to one partner is greater than the excess of the price paid by the other to cover the price paid to the outside country.

The next stage of the argument is due to Lipsey who pointed out that changes in consumption patterns were no less important an effect of customs unions than changes in production patterns. We conclude: a) The consumption effect may operate even if there is no production effect. b) Welfare may be increased by the formation of a customs union which results solely in the diversion of trade from lower-cost to higher-cost sources of supply; this is because the beneficial effects of a better consumption pattern may outweigh the adverse effects of a better/worse production pattern. c) The welfare gain in (b) shown above

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2. Economic Integration in East and West: Bracwell-Miles (1975), Chapter V.
may be enjoyed by the country whose import trade is diverted by the customs union area considered as a unit and by the world as a whole; if the importing country gains, the customs union must gain, but the world as a whole may gain or lose. There is thus a symmetry between production and consumption. Consumption effects can reverse the welfare loss from trade diversion. Lipsey correctly sums up by saying "that when consumption effects are allowed for, the simple conclusion that trade creation is "good" and trade diversion is "bad" are no longer valid". The distinction between trade creation and diversion is not one on which welfare conclusions can be based. On the contrary, if a customs union creates trade it increases welfare; the diversion is within the union. Trade creation is economic whereas diversion is uneconomic only if, first, any beneficial consumption effects are outweighed by adverse production effects and if, second, production effects are adverse rather than beneficial, i.e., adverse production effects of trade diversion can be outweighed by beneficial effects on consumption; but beneficial production effects of trade creation cannot be outweighed by adverse effects on consumption. There can be consumption or production effects even if there is no trade creation or diversion. Lipsey's analysis is thus more fundamental than that of Viner's. Further, Bhagwati has pointed out that trade diversion need not reduce welfare even if consumption is in fixed proportions in the importing country, provided that production is variable. The movement of home production from protected to competitive activities may more than compensate.

3. Economic Integration in East and West: Bracewell-Milres(1976), Chapter V.
Appraisal of Customs Unions: 1. A customs union is more likely to increase the combined welfare of the union partners than the welfare of the whole world. 2. A customs union can cause no trade diversion unless the importing partner country's tariff was less than its cost disadvantage, otherwise the importing country would have produced domestically instead of importing. 3. A customs union can cause no trade diversion unless the common external tariff exceeds the difference in selling price between the importing country's union partner and the outside world; otherwise the importing country will continue to import from outside. 4. The trade diversion caused by a customs union is not harmful to the combined interest of the union partners unless the increase in the importing partners' purchase price exceeds the other partner's gross profit; otherwise trade diversion is helpful. 5. The trade diversion caused by a customs union is not harmful to the combined interest of the world unless variable costs are greater in the exporting union partner than in the outside world; otherwise trade diversion is helpful. (The last four conditions are cumulative and must be satisfied simultaneously. Taking trade creation/diversion and harmful/helpful trade diversion together the chances of harmful trade diversion would be one in sixteen). 6. If the exports of the outside world are neither complementary nor competitive with the products of the union partners, the formation of a customs union benefits the outside world through the increase in the purchasing power of the union partners, provided that the common external tariff is not above the break-even level. 7. The possibility of trade diversion presupposes that the products

4. Bracowell-Milres, Chapter V.
concerned are competitive in consumption as well as in production; trade diversion is not possible if the products are complementary or independent. (Substitutability or competition is a more usual relationship than complementarity). These two last conditions are further strengthened by incorporating the argument about consumption effects in the importing country (Lipsey) and the argument about production efforts in the importing country (Bhagwati). The likely harmful trade diversion will now be one in thirty-two. This only shows the structure of the argument and not the precise probability. The a priori likelihood of harmful trade diversion is therefore small. Further developments have shown that trade diversion is possible only at the level of a sub-industry and on a smaller scale. (Salassa).

The concept of harmful trade diversion depends on the cumulative probabilities of a number of different assumptions. It does not hold equal position with trade creation in this respect. Those assumptions and probabilities are logically cumulative. Viner is right in pointing out the possibilities of harmful trade diversion but it is wrong to infer that it is as likely a result of customs union as it is a general increase in welfare. The Viner effect is highly unrepresentative. There is a general presumption that customs unions increase welfare. This conclusion tallies with common sense. The creation of trade barriers cannot in general increase welfare or even leave it unchanged; welfare must therefore in general be increased by their removal. Trade diversion may reduce welfare in particular situations; but these situations are far from easy to identify in practice. Hence the presumption in favour of customs unions. To sum up, theoretical analysis favours
customs unions; practical experience gives a more cautious assessment. The assessment of any proposed customs union depends on what political or even economic considerations modify the initial theoretical arguments in its favour.

Developments to the Theory: The general pattern of analysis since Viner, has been for authors to point out the limitations of his argument, the essentially sceptical nature of the conclusions remaining unchanged. Meade, for example, says: "It all depends upon the particular circumstances of the case"; but admits, "one can start with some general prejudice in favour of a customs union". But this is faint praise. What is wrong is the assumption that the injurious cases are almost as likely to be found as the beneficial. We have seen that this is not so. There have been many modifications and refinements introduced into Viner's analysis.

The principal modifications and refinements to Viner's analysis are the following:

1. Consumption is treated in parallel with production, changes in consumption patterns induced by changes in relative prices matching changes in production patterns induced by differences in relative costs;

2. This distinction between production and consumption effects can be replaced by a distinction between inter-country substitution (trade diversion and trade creation) and inter-commodity substitution (response to price changes), the latter distinction having the advantage of taking into account all the secondary and subsequent consequences of the changes in production and consumption patterns;

5. Economic Integration: Brearwell-Milres, Chapter V.
3. The simultaneous treatment of consumption and production of inter-country substitution and inter-commodity substitution which employs the concept of the price elasticity of demand; the linking of production with consumption; and
4. Costs include not only costs of production but also costs of marketing, the linking of production with consumption; and
5. The assumption, that unit costs are unchanged as production rises, is dropped and any pattern of unit costs is admitted as possible. The list is not exhaustive and the complexity is great. But we are in no need of them. Their analyses lead to conditions which increase welfare and make it less likely. But our analysis shows that the favourable conditions are a priori more probable than the unfavourable. Nine propositions could be listed which provide a clear and succinct exposition of the effects of changes in the volume and terms of trade between the union partners and the outside world. They are as follows:

1. A customs union is more likely to increase the welfare of the union partners if prices in the outside world are high and variable costs in the exporting union partner are low.

2. A customs union is more likely to increase the welfare of the whole world if variable costs in the outside world are high and in the exporting union partner low.

3. A customs union is more likely to increase the welfare of the union partners and of the whole world if the union partners' volume of trade with the outside world is a small proportion of their domestic consumption; the free-trade effects within the customs union will then outweigh any possible losses from price distortion between the union and third countries.
4. A customs union is more likely to increase the welfare of the union partners and of the whole world if the union covers a large proportion of world production, consumption and trade.

5. As the degree of preference increases, the likelihood of harmful trade diversion increases relatively to that of trade creation. Thus welfare is more likely to be increased if given tariffs are reduced than if they are abolished.

6. Welfare is more likely to be increased if the economies of the partner countries are at present competitive but potentially complementary.

7. Welfare is more likely to be increased if the partners' previous tariffs were high.

8. Welfare is more likely to be increased if the partners are each other's principal suppliers and customers.

9. Welfare is more likely to be increased if there is a large potential reduction in unit costs in exporting industries within the union.

How far does economic integration increase or diminish as the process of integration intensifies as regards the height of tariff, capital movement and movement of labour? In general, the intensification of integration is more likely to increase than to reduce the balance of advantages of the creation over the harmful diversion of product and factor flows. As regards MFN it becomes first progressively more important and then progressively less important. This favours intensification. Thus the benefits of integration to specialisation, economies of scale and economic growth will in general increase as integration intensifies.
We thus get a spectrum of views on trade creation and diversion ranging from pessimism through even chances to optimism. The crux of the matter is that harmful trade diversions are rare and small and structurally remote if all assumptions and probabilities are taken into account. We now proceed to take a brief note on preferential treatment.

**Preferential Tariffs:** Preferential arrangements are only custom unions on a smaller scale. The case against them is that a) their initial effect on the outside world is adverse; b) their ultimate effect may be adverse on the partners and on the outside world; c) the choice of partners and the nature of the preferential arrangements are not random but chosen so as to secure the maximum benefit for the partners and leave any disadvantages to be suffered by third countries; d) this state of affairs may have to be accepted by third countries if the partners are willing to carry integration as far as a customs union or beyond, but can more easily be resisted if the preferential arrangements are more limited in scope; and e) when state intervention in the management of the economy is as widespread as at present, even preferential arrangements falling short of a full customs union are likely to go beyond a mere reduction of tariffs, and the possible distortion of trading relations with third countries is correspondingly greater. The case in favour of preferential arrangements is simply that they represent a reduction of barriers to trade and can thus be considered desirable unless proved otherwise. Moreover, preferential arrangements can in principle be as non-selective as customs unions, a given

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6. Economic Integration: Tracewell-Milres, Chapter VI.
proportion of the maximum possible tariff reductions being applied to everything, even though in practice preferential arrangements may be tailor-made to suit particular interests in the partner countries.

Random or haphazard groupings are, on balance, likely to benefit the world community of trading nations; the danger comes from groupings designed to satisfy particular interests within the partners' economies at the cost of inflicting greater losses on others inside and outside. The League of Nations and Viner were against haphazard formations unless based on reasonable economic considerations. Viner himself noted that in practice the motive for tariff unification was often protection and/or promotion of self-sufficiency in these larger areas. Random or haphazard preferential groupings enjoy the general presumption in favour of customs unions, subject to greater benefits obtainable from a complete union by comparison in which the partners' products are competitive with each other.

**Empirical Evidence:** It is possible to make a) an assessment of the trade creating and trade-diverting effects and b) the probable magnitude of increased efficiency in resource use that can be expected as a result of the abolition of the tariffs among the union partners. By following this procedure we neglect all possible dynamic effects of the union formation. It has been argued that these dynamic effects are very important and of considerable magnitude. But reliable empirical evidence does not exist and following the usual procedure we will limit ourselves to actual attempts at quantification.

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7. European Integration: Michael Hodges (1972), Chapter (Penguin); International Trade: Neller, Chapter XI; and
The most comprehensive attempt to measure the trade existing and trade-diverting effects of the EEC has been undertaken by Bala Balassa. A crucial assumption of Balassa's study is that the income elasticities of demand would have remained unchanged in the absence of the formation of the union. If we should observe, therefore, that the export income elasticity of demand for imports (from partners countries or all countries combined) actually increased, we may take this as an indication that trade creation occurred. If, on the other hand, the income elasticity of demand for imports from non-member countries declines, we can take this as evidence of the trade-diverting effects of the union. Using aggregate data, Balassa finds some evidence of trade creation and no indication of trade-diverting effects. But disaggregation of the data shows that individual commodity classes experience both creation and trade diversion. In a parallel study of the CACM W.T. Wilford comes to similar conclusions. His data shows that during the first seven years of the CACM aggregate net trade creation occurred. Using disaggregate data he finds net trade creation for most classes of commodities with some exceptions. We should note, however, that these results are merely indicative of the short run effects of the common market formation and say little about the long-term repercussions.

Turning to the second problem of the size of the gains from the union we have several pieces of fragmentary evidence. Depending on the precise assumption made as far as possible exchange rate adjustment is concerned, Verdoorn estimates that intra-European trade is likely to increase 15 to 19 percent. Total gains from trade was less than $1 million as a result of the formation of the Union. Scitovsky made a similar estimate
and found that intra-European trade would increase by 17\%.

Harry Johnson estimated the once-for-all increase in national income for U.K. on entry into EEC as less than one per cent of the GDP. Similar estimates were made for Europe by Scitovsky and were found to be very much smaller. Even if we allow a large margin of error in the estimates cited, we still find that none of the numerical data available suggests sizable gains due to the formation of customs unions. But we should point out again that these estimates of gains refer to static gains only. Dynamic gains may be expected to be higher, but in the absence of at least fragmentary empirical evidence it is difficult to say anything concrete.

Another interesting empirical evidence worked by Williamson and Bottrill (1971) shows that by 1969 intra-community trade in manufactures was over 50 per cent higher than it would have been had the EEC not been formed. This demonstrates the effect of internal tariff disarmament on intra-community trade after its formation in 1959, i.e. within ten years. At the same time, whilst the average annual percentage increase in imports from third countries was negligible, intra-community trade increase was double, i.e. from 9 to 10 & 14 to 22 between 1959 and 1967.

**Benefits:** We might consider the benefits to be derived from economic groupings among developing countries. A union is likely to 1) stimulate the establishment and expansion of manufacturing industries on a more rational basis, 2) increase the gains from trade, 3) provide benefits from intensified competition and 4) improve the region's terms of trade. Improved substitution has led to industrialisation but it has become compartmentalised.

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8. Leading Issues in Economic Development: Heier (Note on Integration)
and wasteful. In contrast, in a customs union, manufacturing industry may attain a higher level of productivity than under protection in each country. Greater specialization within the region can increase exports and imports and reduce the excessive number of protected firms. Larger output allows for increased scale. Secondary industry becomes more efficient with specialization. A more rational pattern of production and trade within the region may therefore be an important result of integration. It also attracts foreign investment. New industries can become increasingly competitive and eventually be able to export manufactured goods to the outside world. But it depends on establishing a sufficiently wide market within the union to allow operation on a large enough scale.

An expansion of trade among the member countries is also expected to result from the removal of trade barriers. There is trade creation and trade diversion which affect the gains from trade. Many factors determine which would dominate in the particular union. We have to take into account the pre-union tariff rates among the members, the level of the post-union external tariff compared with the pre-union tariff levels of each member country, the elasticity of demand for the imports on which duties are reduced, and the elasticities of supply of exports from the members and foreign sources. We have already noted that notwithstanding the correctness and importance of Viner's central proposition a general presumption in favour of customs unions remains. Unlike the pessimist and neutral view on the subject by economists, we are as discussed earlier, able to take an optimist's view of the trade creation/diversion and harmful/helpful diversion proposition. The formation of a free
trade union might also result in an improvement in the region's commodity terms of trade. Finally, regional integration might be beneficial in encouraging competition among the member countries. Technical efficiency in existing industries might then be improved, it may also raise the rate of growth of productive resources.

9 Objections: A number of objections have been raised against proposals for regional integration, and actual negotiations have encountered serious difficulties. Political problems take precedence and the administration of the union may be extremely complex. There are also several economic objections to a union. The case for an economic union is in reality weak when the constituent countries have not yet established industries. Limitations on the supply side may serve more as a deterrent to the creation of an industry than is the narrow market on the side of demand. If the production conditions do not also improve the mere extension of the consumer market will not be sufficient to create industries. A union will not cause substantial improvement in the utilisation of resources unless industries have already been established, but need wider markets. Another condition that would be difficult to fulfil is that the countries of the union should conduct a high proportion of their foreign trade with one another. The real situation is that foreign trade is normally of a small proportion within the region. The gain from regional integration would therefore be small. But over the longer run trade patterns may change with economies of scale and competitive advantage as development proceeds. But nations look to immediate gains in their decision to join a union.

9. Leading Issues: Meier. (Note on Integration)
The case for regional preferential trading arrangements is stronger than that for a general preference scheme if the regional arrangement allows the avoidance of trade diversion. There would be less trade diversion from such an arrangement. The main problem centres upon the equitable distribution of their costs and benefits. The fear of polarisation will act as a brake. Therefore, there should be factors at work which produce growth centres in each participating country. There should be spread effects. Other measures should be adopted to distribute the gains more evenly. Most proposals for regional integration do not yet show promise of sufficient cohesion and policy coordination, while there are potential benefits to be derived from an economic union, due attention must be paid to the possible undesirable consequences.

The Remedy: "Partial Integration" - Although a full customs union may not yet be practicable for most of the developing countries, there are still substantial advantages that can be derived from more ad hoc functional type of regional cooperation, short of comprehensive integration. Measures of "partial integration" may help to avoid the costs of "micro-States" and national development along compartmentalized lines. In particular, the complementary development of specific industries through a regional investment policy has considerable potential. The realization of markets of sufficient size, avoidance of duplication and better location of projects might result. There are a few outstanding examples of multinational investment projects and there should be scope for many more. It is, however, difficult to formulate project evaluation criteria for a region, and more analyses of this problem is required before there can be policy implementation. The reasons according to
Rosenstein-Rodan are a) social welfare functions of different nations may be different, and b) is welfare to be maximised for the region as a whole or for each country. The choice is between output on the one hand and better income distribution and fuller employment on the other. The application of different criteria to multinational and integration projects is not easy. It is difficult, moreover, to give a plausible definition of integration projects which will influence the constellation, selection and location of many projects.

It is also possible for more to be accomplished by way of partial liberalisation of regional trade for certain products or sectors for which they could remove barriers with each other. New products for the region may be suitable for such a commitment if supplemented with a regional investment policy. The Andean Group established in 1972 its first sectoral programme for the development of metal working products with common policies. A regional agreement might also be effective in bargaining over the entry of foreign investment and the import of technology into the region. A unit for this purpose may be created. Once again the Andean Group is a good example of this. Finally, regional cooperation could channel aid through regional integration banks or development corporations. This could avoid duplication of development policies.

Section 2: A Modified Theory for Developing Countries.

The break from tradition: while the setting for integration policies has been Europe, the theory developed is English! The E.C.E. was largely political. The E.E.C. is intended to be an economic community including a customs union, a common market for
labour and capital, harmonised economic legislation and a high degree of cooperation in economic policy. The motive for this and other projects were, among others, to improve the international division of labour, increase competition, make possible the exploitation of large-scale economies and to gain increased bargaining strength in trade policy. In contrast, the theoretical framework for studying the economics of integration has its roots in the classical English theory of foreign trade and is in fact restricted to a theory of customs unions. Viner, Meade and Lipsey developed it. The ordinary assumptions for the pure theory of foreign trade are accepted. The problem is whether abolishing duties on imports from some countries and retaining them against the rest is a move towards higher welfare for the country studied, for the members of the union and/or the whole world. It is fundamentally an application of the theory of second best within the neo-classical framework.

There is now in the literature the germ of a new approach to customs union theory with an altogether different starting point. The best representation of this new line is found in the work by Johnson, where the basic assumption is that governments have introduced tariffs for reasons of economic balance, to offset divergencies between private and social costs or benefits, etc. The work of Becker, Breton and Downs has broken the path for this kind of approach, which is also found in two articles by Cooper and Hassell. The latter, after criticising customs unions, work with the hypothesis that the objective of protection is a diversified industrial structure, and work out a theory of how a customs union may retain enough protection for non-competitive
industries, while at the same time some market-swapping with union partners makes it possible to increase the degree of specialisation and thereby keep down the cost of this diversification. Their point seems valid and their contribution is an interesting extension of the theory, but not a replacement of the traditional approach with focus on national product.

**Static and Dynamic Effects**: Viner's famous work of 1950 challenged the hitherto held assumption that customs union would increase the sum total of welfare. Meade pursued the work and considered it by taking into account a number of factors like tariff heights, size of cuts (preferential area), competitiveness or complementarity of the economies, elasticities of demand and supply, the change in the amount of consumer surplus, the effect on the terms of trade and relative income changes. The theory as it has been developed by Meade and others is pretty tough fare and serves to sharpen the intellectual teeth. There are two reasons for its not being a useful guide for practical policy: the 'static' effects of trade creation and diversion are less important than the 'dynamic' effects on growth rate via influences on competition, investment and the balance of payments; and customs unions are set up for political reasons rather than on econometricians' forecasts of changes in trade, from which it follows that economic analysis would be more fruitfully focussed on the implications of economic policy based on the existence of customs unions rather than on the justification of customs unions in terms of the forecast changes in the flows of trade.

During the last two decades the view has gained ground that the static analysis indicated by Viner's approach is in any case relatively unimportant, even if this approach can be subjected
to an elegant theoretical analysis and to quantitative forecasts of greater or lesser plausibility. Lipsey accepted that the best estimates gave "figures of the net gain from trade amounting to something less than 1 per cent of the national income". This is a small inconspicuous quantitative results. It clearly needs only a small dynamic effect on the rate of growth of GNP, say an increment of 0.1 percent a year compound for twenty years, to far outweigh effects of this order of magnitude due to trade creation and trade diversion. Further, this static effect is an once-for-all increase in the GNP. Balassa says: "In evaluating the effects of economic integration, we shall take dynamic efficiency as the primary success indicator".

Three arguments were examined in relation to Britain's entry into the EEC. They are the balance of payments, economies of scale, and the infant-industry arguments. The first argument was considered as one capable of being solved through devaluation. (But chronic deficit?) The third argument cannot be considered a dynamic factor as economic theory does not support the argument. (But the theory of growth has not developed in relation to economic integration.) Moreover Prebisch has justified protection in underdeveloped countries. Streton has discussed the problem with particular reference to economic integration in Europe (1966) in relation to backward regions like Southern Ireland and Southern Italy. The pessimistic view seems to be more correct than the classical view, as experience shows, because comparative advantage will be continually undermined at the existing exchange rate. The second argument seems to be valid for the U.K.

gains for the U.K. from a larger market than the U.K. could be significant. This affects investment as in the case of a firm, because of a 'climate of competition'. Thus the dynamic gains due to considerations of 'scale' and the 'climate of competition' seem likely to be far more important than the static gains or losses due to trade creation or trade diversion (Balassa, Scitovsky and others have argued on these lines).

The traditional theory makes the same basic assumptions as the static theory of comparative advantage. Specialisation, changes in the terms of trade and economies of scale are the gains from integration of customs unions. They result in larger plants and horizontal and vertical specialisation. Though the theory has relevance to developing countries, the extent of it is the question. Are we to depend on trade creation? In recent years the assumptions, hypotheses and criteria of conventional view have been questioned. Doubts about applying the same criteria have been raised. The theory does not say about potential gains from regional arrangements for developing countries. The trade patterns of developing countries are not conducive to gains. In a static context, it is inappropriate to talk about trade diversion in relation to these products (capital and intermediate imports). There would be only small opportunities of gain (Allen). Critics of the traditional theory do not, therefore, conclude that integration is not justifiable but rather that its analytical categories have limited relevance to the problems of developing countries. There are gains, but not gains of static customs unions analysis. Static theory is of little use for evaluating the desirability and consequences of integration among developing countries.

The dynamic approach questions the assumptions based on static welfare. The major criteria for the developing countries is not allocation of resources, but acceleration of the rate of growth. It looks to beyond the existing patterns of production into the future, and to economic growth and structural transformation. Actual trade flows and other conditions are largely irrelevant. Hence protection is necessary for developing countries on dynamic grounds because of growth effects. If there is no case for protection there is no case for integration. The assumptions are quite different for both. This is the basis of industrial development and import substitution. Integration reinforces these growth effects and makes it possible for undertaking industrial development, taking advantage of economies of scale and specialisation within a region. The desire for industrialisation and agricultural development led economists to reformulate customs union theory for the developing countries. Trade diversion becomes an objective for gains from integration. Integration uses specialisation and economies of scale which result in gains and economic growth. The principal effects of such an integration would be a reduction in the costs of protection and acceleration of the rate of growth, and the increase in the size of the market. The external economies to be gained by market expansion are important for developing countries. There would be new industries and increased investment within the Union. Savings also will increase. Competition will spur them to efficiency. The dynamic gains over the long run may prove to be more important than the short-period gains through the allocation of a given amount of resources. What applies to industrialisation applies equally well to agricultural development. The situation with regard to primary
commodities would also improve with better utilisation and better bargaining position. The trade with the outside world would also increase with changed patterns. Mikesell was optimistic when he said: "In this sense therefore there is no overall trade diversion, only trade creation."

An important implication of an approach to economic integration which accepts a preference for industrial development as a legitimate policy objective, is that it is no longer necessarily appropriate to evaluate integration schemes in terms of whether trade creation outweighs trade diversion, for gains from integration can be produced even in the context of a net balance of trade diversion for the region as a whole. To put the matter in another way, integration makes it possible for trade diversion, which may be a valid objective of policy, to be undertaken in a more efficient way.

This approach is clearly in consonance with the possibility that trade diversion may be an efficient way of stimulating the rate of growth of real product in the long run. If protection makes it possible for an increase in real product and its rate of growth in the long run, integration may make it possible for an increase in the potential product or growth rate still further. On the other hand, if protection implies real costs, integration can reduce these, and thus increase real or its rate of growth. Despite the fact that trade diversion is, in this framework, no longer a relevant concept as a criterion of gain, the central point of the traditional analysis remains. This is that specialisation produces productivity gains. These remain fundamental and basic to the case for regional economic integration even in a dynamic context, though the standard of reference admittedly changes.
We might for purposes of clarity categorise the various kinds of benefits of integration among developing countries:

1. The Static Benefits: It is questionable whether integration projects among developing countries will have the considerable static benefits of more efficient resource allocation as are expected to result from integration in Western Europe. a) The pattern of trade among developing countries and the structure of their economies offer little scope for reallocation of output. b) The complementary nature of their economies makes unlikely any large positive static production and consumption effects from integration. c) Most developing countries are characterised by abundant labour resources and a high degree of capital scarcity. Thus the nature of the economies of developing countries suggests that the static gains from improved resource allocation as a result of integration will be minimal. Further, great disparities in the stages of economic development or structures of the economies, dominance by one or two countries in the integrated region or an extremely low level of economic development will tend to keep the economic benefits to a minimum. Economic and trade policies and the wage structure of all the economies cannot be too divergent. Moreover, state ownership and operations and private cartels may tend to nullify economic gain through inefficiency and misapplication of resources. Barriers to the movement of factors of production will tend to reduce benefits. Demand conditions must be similar. "The countries should produce different primary products, but at the same time they must control a significant share of the primary products exported by the region as a whole." (Allen). These additional reasons make us pessimistic as well.

15. The same: Vitzthum.
2. The Dynamic Benefits. Nor is it obvious that integration among the developing countries will yield sizable advantages through the traditional dynamic effects of integration. These include internal and external economies of scale and more effective competition. It is unlikely that the removal of trade obstacles among a group of low-income countries will have any significant impact on the scale of output of existing enterprises. The scope for sizable benefits from scale economies, either internal or external, appears to be small. The scale will be little affected by integration programs. Neither would the terms of trade or the balance of payments improve with the export of primary commodities as they are in the international context. It is suggested that because of this developing countries should foster their own industrialisation. Integration would give them a collective voice in tariff negotiations. The merit of this argument has yet to be tested. The developing countries have not succeeded so far in extracting any concrete improvement in world trade rules for their own benefit, much less will a smaller unit be able to achieve any success.

Then, therein lie significant potential gains. The major advantage of integration for developing countries results from increased market size. It principally lies in the rational allocation of investment for future industrialisation.

3. The New Investment Benefits. Most developing countries have, rightly or wrongly, committed themselves to industrial development behind protectionist barriers. Multiplicity of small plants results in wasted resource. The potential gain from integration

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17. The GACH: Vitatham.
of a number of small markets is derived from a more rational allocation of new investment on a multinational regional basis. Industries would be optimal, thereby reducing average cost below that in a national market protected by tariffs. Thus a given investment would yield more output after integration than before. Regional planning must supersede the current popular national plans. National planners must coordinate their investment programmes so as not to duplicate the investment projects of the other. But this gives rise to the problem of location leading to negotiating snags. Additional investments are encouraged by improved productivity. Larger markets permit larger-scale plants, lower unit costs, and more rapidly growing markets. Private foreign investment is attracted. Foreign exchange cases. Technology and know-how will follow, as well as efficient management. The benefits of customs union will accrue not only from traditional static and dynamic gains, but also from new investments and technology, leading to fuller and better allocation of resources for productive purposes. Though difficult to estimate, they are a driving force for integration.

The Gains from Integration: The potential benefits of integration are the vast opportunities for import substitution and specialisation because the chief reason for integration is the economies of scale. There is a diversification of industry with new sources of raw materials and technology. Existing import patterns change as industries replace imports. The extent of import dependence or outside the area by each country is reduced. Import dependence data may have limited use, but it can act as a first indicator of

substitution possibilities. At the beginning, manufactures are heterogeneous. There is bound to be industrial development and structural transformation. Agricultural development will follow and there will be opportunities for trade expansion in agricultural produce. There will be increased specialisation in food production within the countries and within the region, which increase the produce very considerably. More food production is necessary even without integration as trade increases within the region at the expense of far away trade with the outside world. There are a host of benefits that would accrue as a result of integration, both economic and non-economic.

The difference in industrialisation with and without integration can be as much as 30% in a decade, and contribute 0.5% to GNP rate. This would be a useful though not a dramatic gain. Chenery and U.N. investigation of results of integration gave the following figures:

1) Value added of total manufacturing industry increases slightly by over one-third more than proportionately with per capita income, i.e. the income elasticity of output for total manufacturing is about 1.37.

2) Value added of total manufacturing industry varies approximately by one-eighth more than in proportion to the size of the population, i.e. population elasticity of manufacturing output was found to be 1.12.

3) Elasticity co-efficients range from 1.0 for textiles to 1.91 for basic metals. These are encouraging for integration.

'Some Basic Concepts: Industrialisation, protection, and specialisation form the basic argument for integration. We have
discussed the modifications and qualifications of the traditional theory of integration as applied to the developing countries. One important consideration was the distribution of the costs and benefits of integration. This involved the question of location as a prerequisite for integration and the need for coordination through an appropriate framework for competition. Much of modern manufacturing industry is, in the terminology of Sargent Florence, 'footloose' - which means that it is capable of being operated on a wide range of alternative locations at comparable costs. Bell also says that "the advantages of one site over another are largely man-made rather than nature-made .... It can also be changed by man in accordance with rational and deliberate planning criteria". This overlooks the cost of infrastructure investment necessary to make such industries viable. Nevertheless, where a suitable infrastructure exists, since footloose industries may lack any important natural locational advantages, they will not commence operation if artificial inducements are offered to others. This leads to firms working at less than full capacity. Hence, assurances have to be given. Arrangements have to be worked out. This is an important consideration for the harmonisation of industrial policy by the members of a union. Factors influencing location are: 1. Historical 2. Availability of Raw Materials; 3. Access to Markets; 4. Transport Relations; 5. Power Resources; 6. Labour; 7. Site and Services; 8. Financial Facilities; 9. Natural and Climatic Considerations; 10. Personal Factor; 11. Strategic Considerations; 12. Dynamics of Industrial Location.

Industrialisation has another aspect. There are five phases of industrialisation in developing countries;
1. ISI - Consumer goods - Horizontal development.
2. ISI - Capital goods - Backward linkages - Vertical development.
3. Export promotion - T-type, A-type, and B-type.
4. Export promotion - Regional cooperation in industry and trade.
5. Regional economic integration and self-reliance.

(Consumer goods include both non-durable and durable, and intermediate goods may be considered separately).

A Summary: We shall now try to summarise and restate the traditional and modified theory in order to make it applicable to developing countries. The traditional theory as such is primarily concerned with considerations relating to the efficiency of resource allocations under static assumptions. The theory analyses the circumstances under which gains may be derived from expanded trade among members of a customs union when trade barriers among them are eliminated and when increased specialisation forces them to trade. It makes the same basic assumptions as the static theory of comparative advantages. Problems of adjustments are disregarded. It shows how there are gains from a) specialisation of production, b) improved terms of trade and c) economies of scale. Global welfare depends on trade creation and trade diversion effects. But growth may compensate disadvantages, if any, by increased demand from others. Markets widen and prices shift, and there are savings in costs. Of course the analysis becomes complex with elasticities, and with inter-commodity substitution and consumption effects. No doubt the theory has been refined in many ways. There is generally a change toward optimum conditions.

The theory has relevance to developing countries, but to what extent is the question. The assumptions, hypotheses and criteria of the conventional view have been questioned. The western
criteria is useless. The theory does not say anything about potential gains from regional arrangements for developing countries; Western propositions do not hold much gains for developing countries because trade patterns of underdeveloped countries are not conducive to gains. In a static context, it is inappropriate to talk about trade diversion in relation to these products. Therefore static analysis has only limited relevance to the problems of the developing countries.

The dynamic approach questions the assumptions. Static welfare assumptions are irrelevant. The major criteria for underdeveloped countries is not allocation of resources, but acceleration of the rate of growth. It looks to the future. Actual trade flows and degree of competitiveness and complementarity are largely irrelevant since they do not indicate potentialities. Hence protection is necessary. If there is no case for protection there is no case for integration. The magnitude of potential gain will be determined by 1) the preference for industry, 2) private cost of industrial development, 3) differences in cost ratios of production and 4) the economies of scale. To these must be added dynamic gains. The dynamic effects of integration are produced by 1) the economies of scale, 2) external economies, 3) new industries and increased investment and 4) effects of competition which is a spur to efficiency.

Thus the trade creation and trade diversion have diminished relevance. The basis of integration is protection which has growth effects. The case for integration is based on the case for protection which is based on dynamic growth effects and not that of the static arguments. The assumptions are quite different for
both. In fact integration makes it possible for trade diversion, now accepted as a valid objective of policy, to be undertaken in a more efficient way. The dynamic effects available for integration are not available for a national market. Integration promotes technological change, reduces risks and uncertainties, overcomes costs of distribution and servicing, avoids exchange fluctuations, improves quality and standard, helps linkage effects, etc. Long-run effects are great indeed. At any rate dynamic like static theory rests on specialisation, comparative advantage, economies of scale, and resource allocation. Integration provides additional potential gains. This depends on specialisation and is apart from protection. Still specialisation remains the basic source of gains even though the criteria for underdeveloped countries differ.

A Review of Literature on Integration: We may briefly state the literature on integration that has grown over the last three decades (1950-1980). The traditional theory was developed and refinements made to it by Viner, Meade, Lipsey, Gehrels, Johnson, Cooper and Hassell, and others. Their approach was essentially static. The conventional view was questioned and criticisms levelled against it by those who advanced dynamic arguments. They included western economists like Seers, Mikesell, Salassa, Bell, Damos and others, and economists from developing countries like Paul Prabhak, Urquidi, Kitamura and others. Protection was justified on dynamic grounds by such economists as Nurkse, Myrdal, Seers, Prabhak and others. The inadequacy of the traditional theory for developing countries and their preference for industrialisation led Johnson and Cooper and Hassell to reformulate the theory to suit the process of development in the less-developed countries. They emphasised
the need for integration to overcome the bottlenecks in industrialisation and laid stress on the prior condition for a fair distribution of gains and losses by the intending partners as a prerequisite to integrate with one another. But the seventies have overtaken all the theories and refinements made in the fifties and the sixties and brought the developing countries to formulate their demands for a new international economic order through united action and moral persuasion. The Unctad is their chief platform, and the proposals include economic cooperation of developing countries (ECDC) as one that would pace up their development.

We may also note some of the contributors and their contributions to the theory of integration during the post-war period. Allen had shown that the criterion of gain offers small opportunities of gain for developing countries in general. Lipsey formulated his 'Second Best' theory. Where unilateral action by one to minimise barriers need not necessarily maximise welfare. In a world of restrictions one had to choose the second best. A more restrictive policy would have to be preferred to a more liberal policy. But the burden of proof rests on those who defend it, as measurement is difficult, so that a general presumption in favour of freedom remains. Lipsey has also enunciated the benefit of integration as well as the conditions for integration. Shambri, in arguing for import substitution, has pointed out that both diversion and creation can be a source of gain by reducing costs and enabling imports of capital goods and raw materials for development. Johnson has shown that the direction of the economies of scale is positive but views on the scope for such economies may differ. (But this is purely empirical).
Stigler has said that the division of labour is limited by the extent of the market. Chenery has examined the relationship between size of population and growth and composition of the industrial sector. Hirschman and Scitovsky have worked on backwash and forward linkages and on external economies to be gained. Dell warns against uninhibited flow of foreign investment. Mikosell has worked on primary exports and agricultural development and an increase of total exports by developing countries. Balassa Scitovsky and others have pointed to the beneficial effects of competition while also maintaining the costs of instability. The importance of free trade and unrestricted competition are emphasised by Mikosell, Allen and others. But this is denied by Dell who says that it is inapplicable. Agreed specialisation is regarded as opposing or supplementing the market forces by Streeton and Tinbergen. But Tinbergen favours regional planning as opposed to competition in the heavy industry field. This is of some significance to ECDC. He emphasises that agreed specialisation is necessary for capital and intermediate goods sectors. Competition is not favoured here. Optimal development is possible through planning alone. Johnson and Cooper and Nasser have worked on the distributional effects of industries in their reformulation of the traditional theory. Howard Ellis points to the perils of bilateralism, but bilateralism is more liberal than nationalism and may be an acceptable second-best alternative to multilateralism. Ravindra Satra has made a comprehensive study of factor movements, as well as on effective protection or common external tariff or the height of a tariff. Samuelson has made the famous pronouncement that, 'Free Trade is
the policy that maximises welfare'. Murray Kemp has worked on partial integration but it is a mathematical analysis. Madison argues that capital investment is not merely the most important single cause of growth, but more important than all others put together. Lipsky has made a study of consumption as important as that of production, in integration. Fleming has made an analysis of discriminatory import controls. 'On Making the Best of Balance Payments Restrictions on Imports', Bhagwati says tariffs and quotas can be equivalent.

There are, of course, many differences of emphasis in the arguments of the various authors already cited. But suffice it to say that many of them lend support to the necessity and desirability for integration in some form or other to the developing countries. A number of books on international trade include a chapter on the analysis of customs unions. Besides that of Lipsky, a notable survey has been given by Jaroslav Vanek in his contribution, 'General Equilibrium of International Discrimination', which gives perhaps, the most complete account of customs union theory. But the developing countries will remain indebted to Raul Prebisch for his contribution and work as Secretary-General of the UNCTAD.

Section 3: Proposals Considered by the International Community: The NIEO.

The World Economy in Transition: Since 1971 food and other primary commodity prices have fluctuated wildly. Also relations between the industrial and the developing countries seem to have deteriorated sharply. So, what happens to international economic co-operation? Will it survive? Economists faced with this problem...
have argued for a substantial advance in international cooperation on economic issues, and they have suggested public policies that would strengthen the prospects for economic progress globally through multilateral decisions and actions. The policies they recommend are in relation to: a) International Trade, b) International and Foreign Assistance and c) The International Monetary System. The interdependence involves three commitments: a) International cooperation must involve closer coordination in the management of domestic policies; b) Effective restraints on demands laid to permit full employment; c) Capital and Savings are necessary in future for both groups. Substantial advances in international collaboration are required along with the need for a global approach in which developing-country concerns would receive far more attention in the future. The three proposals mentioned above will go a long way toward a more productive and more equitable international economic system. It is in the interest of the developed countries to concede and grant the requests of the developing countries and usher in a new international economic order. The international economic system has undergone rapid structural change and challenges. Only monetary reforms were ratified while multilateral trade negotiations remain stalled. Almost all issues were held up after the crisis, including commodity trade. International economic relations wavered between cautious cooperation and wary confrontations. What we want now are rules and institutions to limit the economic conflict among nations. We have to reshape the World Economy, and the role of the world economy is the development of the poor nations by the rich ones. The major issues involved in theory and policy in this process are growth and trade, economic structure of rich and poor nations, and aid and trade. It is heartening to note that
there is a very strong section in the West that is able to visualise
the problems of the developing countries in a dynamic sense.
This has a thawing effect on the hardliners who try to circumvent
the major issues by plausible arguments and pious utterances but
yield nothing over the counter or across the conference table.

The New International Economic Order: World trade and national
policies seem to have gone full circle. The demands of the develop-
countries in the framework of Unctad, rejected more than a decade
ago by the rich nations, have become the focal point of the
negotiations between the producers and the consumers. At the same
time, the complexity of the problems appears greater than even
before. The U.S. can no longer impose its solutions on the inter-
national community. In trade policy, the choices have become
increasingly clear and are narrowing the options. American legis-
lation has formally endorsed a generalised system of preferences
for developing countries. So too has the GATT agreed without
insisting on reverse preferences, and grants generalised preferences
to the developing countries. The Tokyo Round has also ended with
a hopeful note without any patch-work system. The rich countries
are obliged to concede preferences for tropical products to the
developing countries, especially the poorest who need development
funds. But the North-South Dialogue has ended in a failure because
the concessions granted were of fringe benefits and did not concede
on any of the major requests of the developing countries. All
literature on the subject of a new order beat about the bush and
evade the real issues. In fact, the Unctad is categorically clear
on its stand in espousing the cause of the developing countries
in very unmistakable terms, especially with the third development
decade in view. The North-South Dialogue has led to frustrations
and mutual recriminations. The third world wants - 1) Sovereignty over natural resources, 2) end to violent fluctuations in commodity prices, 3) Increased industrialisation, 4) Indication to link raw material export prices with ever-rising prices of manufactured imports, 5) Transfer of resources on a stable and adequate basis, 6) Relief from their intolerable debt burden, and 7) Code of conduct for transfer of technology - a very large package. The Third world is weak, but there is one strength - their political unity. This is being used with great skill by them. This will be important hereafter, but more difficult to maintain because they may be divided by the lure of short-term gains and separate deals with the rich nations, e.g. petroleum countries and their damage to Third World. The North wants minor adjustments to the old system for a new deal rather than a new international economic order. Besides, there is the protectionist measures of the developed countries which is a stumbling block to the developing countries. The question of the transnationals has also to be reviewed. They exploit more than they help. They do not work with national objectives. The urgency of the solution to the manufactures and the commodities of the developing countries cannot be better emphasised.

20 The Controversy over the UNCTAD: Some economists have criticised the UNCTAD. They say it will ultimately damage the poor countries by creating a psychological barrier in the developed countries. A notable critic is Johnson who goes to the extent of remarking

thus: "Whereas the ancient empires were built and held by military conquest and force, the new empires of the poor nations are hoped to be built by political majority in the U.N. and kept by moral blackmail on the one hand and the extension of the power of an international ruling class of international officials and experts on the other". Bad enough, as this is, his statement in the same context is worse still on the NIEO, especially on the IPC. Paul Streeten says, "I agree with everything Harry Johnson says, but I will fight his right to say it (especially in his particular way)". Nothing could be farther from reality, especially with a priori reasoning of the critics who have not cared to evaluate the problem from the empirical point of view, nor on the economic consideration of the two groups concerned. Behrman has called the lie direct by his evaluation. The NIEO is not a demand to replace the market system by a vast network of bureaucratic system. There is no intention to deprive others arbitrarily of their economic, political and human rights. Nor should the people of the poor countries be divorced from their governments. These criticisms are not valid and are beside the point. A panel discussion on the NIEO by eminent economists cast doubts on the package deal as being outside the pale of economic thinking, analysis and policy prescription in the development area. But the proposals are sound and logical. Mr. Critic thinks the reliance on the market is "laughable", and Mr. Ali A. Mazrui says the moral questions are answered. He further says, "It looks as if Third World leaders get it either way. They are guilty of elitism or of socialism. They are either condemned as corrupt or as interfering with the market. For the time being they are at best caught between the indignity of charity and the ambition of economic justice. Is it
surprising that they long for some new international economic order?". "Those who accuse the Third World of being 'economic illiterate' may sometimes be political simplists themselves. They may also be steeped in historical naivete".

However, the summary judgment by scholars and policy-makers is that the analysis, to date, is far from adequate. Most of it is a priori argument without appeal to empirical evidence. Simulation results, however, reveal possible gains from the Unctad proposals. There are more reasons to consider the proposals seriously than have most other previous analyses. I.M.D. Little has suggested a limited approach in view of financial implications. Tea and jute are the commodities that are almost entirely produced in the poorest countries and that affect most poor peoples. He thinks £3 billion spent on improving prospects for the producers of these two commodities would be a better use of public money than the Unctad scheme of buffer stocks and common fund.

Thagwani has endeavoured to bring about a compromise on the issue of NIEO. He traces the present posture of the developing countries to three factors: 1. Shifts in perception of existing international economic order; 2. Post-OPEC emphasis on collective action; the rise of "trade unionism"; and 3. Populism: A political desire to participate in decision-making. The confrontation from the West comes from the concepts of sovereignty and efficiency. They have to be cooled and circumvented to usher in reforms in the international economic system. In a sense, there is already a transitional economic order. The developing countries are already active participants in negotiations. How should the North-South negotiations acquire desirable dimensions? What targets are to be evolved? There are two major principles of
reform: 1) the developing countries must receive an increased share of resources under the NIEO; and 2) bargains must be struck which are mutually profitable and which therefore appeal and also to the developed countries' interests in areas of trade policy, regulation of MNCs, transfer of technology, migration and food policy. The NIEO can thus be made a reality that accommodates the major political preferences and economic objectives of the developing and the developed countries. The two principles are therefore, 1) resource transfers and 2) mutual-gain bargains. These are worth considering. But the developing countries are not satisfied with peripheral concessions, and would rather wait to achieve than succumb to these. It is even suggested that the developing countries should exploit the existing disorder than hope for potential gains in an ideal system whose creation is most unlikely.

*Collective Self-Reliance:* The present development strategies of most developing countries depend on financial inflows from abroad. But it has given rise to the fear that industrialisation has turned into dependant industrialisation, benefiting more the home than the developing countries. It is the prevalence of TNCs in the economic life of Third world states and their relevance to all main areas of the NIEO programme that are at the root of the developing countries' insistence on the principle of permanent sovereignty of every state over its natural resources and all its economic activities and of their quest for greater control over TNCs. Proposals for reforms have been mooted. Hence the concept of individual and collective self-reliance signals the beginning of growing efforts to reduce this dependancy through the increasing mobilising of its own resources. The achievement of self-reliance
demands fundamental internal and external changes. In its external dimension it requires a change in the structures of vertical interactions between developing and developed countries, in the direction of structures of horizontal interactions among developing countries. Trade among developing countries, for instance, accounts for only one-fifth of their total trade and this share has been declining. What is necessary, therefore, is increased economic cooperation among the developing countries and a whole set of relevant measures ranging from the facilitation of intra-third world interactions to direct collaboration efforts. The developing countries will have to avoid inconsistencies and fragmentation in the pursuit of collective self-reliance. It should encompass in a harmonious manner several measures and elements designed to secure the greatest advantage from multinational action.

**Economic Cooperation Among Developing Countries:** The UNCTAD has written on "Economic Cooperation Among Developing Countries" which is worth complete perusal. It reviews the international scene during the last decade and covers the problem of strengthening economic integration and of cooperation outside the framework of integration groupings among developing countries. The seventies witnessed a series of Conferences and Resolutions on the subject on the initiative taken by the UNCTAD. The Programme of Action on the UNCTAD formed the basis of discussion at all economic conferences. The development of collective self-reliance is an integral aspect of the UNCTAD and one supported by all sections of the international economic cooperation; it has been given a new and more profound emphasis. Collective action has been advocated to secure equitable and remunerative prices and stable markets for basic export commodities; to grant preferential treatment in trade relations
among the developing countries; to promote payments arrangements; to have joint action in the fields of industry, science, technology, transport and shipping; and to cooperate in the use of financial resources available for development. A number of initiatives have been taken to give concrete shape to the new trend towards collective self-reliance. But they could be hampered by the absence of institutional structures specially geared up to existing possibilities. Fortunately unity of action is reinforced by their advantage in population and in the natural resources which they possess. They enhance the collective bargaining power with the developed countries. The development of an integrated global system for economic cooperation among developing countries would help to avoid inconsistencies and fragmentation in the pursuit of collective self-reliance.

Accordingly the system should include the following: 1) The strengthening and broadening of sub-regional and regional economic cooperation in a manner consistent with global cooperation among developing countries as a whole; and 2) A set of inter-related policies, mechanisms and institutions designed to implement new forms of joint action within a wide framework of third world cooperation; with special provisions included in favour of the relatively less advanced countries. This is the new global development strategy.

But experience points to a few areas where improvements and new initiatives require priority attention. First, inter-governmental machinery and community institutions need to be improved in order to harmonise national and common interests and to reflect the agreed goals of economic integration of the grouping concerned. Secondly, the existing instruments themselves
need in many cases to be revised so as to make them more effective. Thirdly, the measures for the least developed member countries of economic groupings need to be revised to make them automatic for the sake of effectiveness. Fourthly emphasis should be shifted from trade matters to industrial and agricultural resources and to transportation infrastructure. The promotion of economic cooperation in the developing world as a whole could be fostered through the strengthening and outward expansion of regional groupings. This could lead to a greater involvement of neighbouring states with different degrees of economic integration. In like manner different groups could cooperate in trade expansion and productive enterprises without creating inconsistencies. Trade could be promoted through preferences and agreements, through measures to improve exports and imports, and through a system of payments clearing arrangements. There could also be cooperation in production through international instruments and through measures at the national level. The scope is wide and varied.

21 The Unctad and the Nogo: We may divide the work of the Unctad regarding the Nogo into three phases: 1. Upto Nairobi; 2. Nairobi to Manila and 3. Manila and after. The buoyancy created by the fifties and the sixties was expected to go on to the Seventies as well. The prevailing framework was accepted. So the strategy for the Second Development Decade was based on this. But events in the early Seventies changed with a series of crises. There was the abandonment of the convertibility of the dollar by the U.S. and the abandonment of fixed exchanges established by the IMF. There

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21. Speech by Dr. Samani Corea, Secretary-General, UNCTAD, in Colombo (December, '79 January, '80); and Marga Report on ECDC (Colombo).
was recession combined with inflation, i.e., stagflation. The rate of growth of 3-3% was not realised and aid strategy disappeared. On the top of all this the oil crisis had come as a bang. The performance of the developing countries fell. So the strategy of the Second Development Decade was undermined. The series of crisis therefore called for a new approach and new orientations. Aid was far below the requirement. The Sixth Special Session of the U.N. in 1974 made its famous Declaration and Programme of Action on a NIBO calling for a structural change and collective self-reliance as the two concepts of the NIBO. Thus there was a shift in the emphasis on the NIBO as distinct from the strategy of the Second Development Decade. There was to be a new international economic relations and collective bargaining. The NIBO was meant to cope with the new challenges arising, and this was to be met by the Unctad. The Sixth Special Session dedicated itself to commodity problems and advocated an integrated approach and international intervention in markets. About 6 billion dollars was thought to be necessary for this. The existing framework needed to be changed. Unctad concretised the issues of the NIBO. Nairobi gave Unctad the mandate for negotiations. Though many other issues, including regional economic cooperation, were discussed at Nairobi, the commodity issue dominated the discussions. Thus Nairobi paved the way for negotiations for the first time. This was a significant event for all.

Nairobi served as a launching pad for an extensive negotiating process, but before it could conclude Manila came in and the agenda had to be wide unlike at Nairobi. The Agenda included a wider field than the resolutions at Nairobi. The main theme was structural change under all items and also as a separate item. Both Nairobi
and Manila gave heavy work for the Unctad. Manila had gone beyond the mandates of Nairobi. Any way the negotiation process was under way and Unctad became the centre of the great debate on development and the international framework for development. The Group of '77 and the North-South dialogue developed with the Unctad. The foundation was laid by Prebisch and his paper, and western hostility had been somewhat transformed. The essential ingredient was the necessity for the unity of developing countries. Perhaps the Unctad played a greater role in the progress of the strategy than the Developing countries. The Unctad felt one with the cause as much as the WHO would commit itself say to the eradication of malaria.

The early seventies had given a rude shock to the post-war framework. The International community was therefore invited to confirm their conviction that structural changes were needed. Though the Manila Conference gave mandate to the Unctad in several fields and key areas for negotiation there was no agreement on structural changes. A meeting of the U.N. in August this year is expected to take up the issue of global negotiations rather than allow the North-South dialogue to produce a stalemate. Already one epoch has gone and another has begun. The Eighties is going to be a difficult period. Numerous crises have occurred and one thing is certain that the framework of international economic relations will not continue hereafter as before. A new scenario is ahead. The economic field will be linked to the political. Disarmament and food will be important issues in the Eighties. They will affect development. Energy, monetary and financial systems, world trade, and South-South issue will grip the world
scene. The institutional framework of the Unctad also needs changes in order to face the new problems. Many developments have undermined the old framework. A new framework is therefore needed for international economic relations. This is an imperative. The Unctad has provided the new framework of proposals which the international community has accepted for implementation. The eighties will witness it.