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U.N. CONFERENCE ON TRADE AND DEVELOPMENT PART 2
BLOCKING ECONOMIC GROWTH

Should United Nations institutions foster the creation of more OPECs?

Should the poor in the developed countries subsidize the rich and the super-rich in the developing countries?

Should the prices and supplies of vital raw materials be managed by international bureaucrats?

Should the prices of the raw materials produced by developing countries be indexed and tied to the prices of manufactured goods produced in the developed countries?

"Yes" is the answer to all these questions offered by the Secretariat of the United Nations Conference on Trade and Development (UNCTAD).

UNCTAD is a Geneva-based agency of the General Assembly of the United Nations. It has a staff of 448 and a two-year budget of $56.5 million, of which $14.1 million is supplied by the United States. The organization was founded in 1964 to consider the relationship between international trade policies and economic development in the Third World.

Like those of most U.N. institutions, UNCTAD's rhetoric, resolutions, and actions have become increasingly hostile to the West, to free enterprise, to multinational corporations, and to the private sector.

This is the second installment in a five-part series examining UNCTAD. Part 1, "Cheating the Poor," appeared on May 3, 1984 as Heritage Backgrounder No. 348.

What is unique about UNCTAD is that, so far, it is the only U.N. institution that has become a "brain trust" for Third World radicals. UNCTAD's Secretariat is a veritable "think tank" spewing forth one collectivist idea after another. Given this collectivist orientation, it is bad enough that the U.S. had to provide UNCTAD with $7 million, or 25 percent of its budget last year. What is worse--and tragically ironical--is that the schemes proposed by UNCTAD's Secretariat would almost surely make it more difficult for developing countries to grow and prosper.

The original philosophy underlying UNCTAD was simple and sensible: Third World countries should obtain the external resources they need for development programs through increased trade instead of foreign aid. The cry of the Third World majority at UNCTAD's first plenary meeting in 1964 was "Trade, Not Aid." Thus, the original UNCTAD task was to find ways to increase the capacity of developing nations to produce more, to trade more, and to reduce, if not eliminate, trade barriers in the developed countries.

While the basic objectives of UNCTAD are unexceptionable, the programs its Secretariat proposes are another matter. Over the past decade, UNCTAD's major initiatives have been concerned not with creating wealth or increasing trade but with organizing cartels, intervening in markets, rigging prices, and extracting in other ways greater funds from the developed countries. The programs espoused by UNCTAD's Secretariat and its Third World majority reveal a change in the organization's philosophy from "trade, not aid" to "mandatory transfer payments, not aid." The difference between these two is the difference between wages and welfare.

Reflecting this change is UNCTAD's most far-reaching proposal so far--the Integrated Program for Commodities (IPC), "centerpiece" of the Third World's concerted drive to establish a New International Economic Order (NIEO). As perhaps the most comprehensive economic program ever placed before an international organization in peacetime, the IPC continues to deviate from UNCTAD's original mandate. It proposes manipulations of the essential commodity market intended to help Third World economies, which perversely will only hinder genuine growth and development.

THE INTEGRATED PROGRAM FOR COMMODITIES

Largely the creation of the UNCTAD Secretariat, the IPC was first unveiled by the organization's Secretary-General, Gamani Corea, at a meeting of the organization's Trade and Development Board in late 1975. The major purposes of the program were:

1) To maintain the fluctuations of commodity prices within "equitable and remunerative" price ranges.

2) To stabilize prices and export earnings.

3) To raise commodity prices and export earnings.

4) To arrest the alleged declining terms of trade between primary products produced by developing countries and manufactured goods.

5) To assure developed countries "access" to supply.

To reach these goals, UNCTAD proposed:

1) Negotiating individual commodity agreements for ten stockable commodities of interest to developing countries--coffee, cocoa, tea, sugar, copper, tin, rubber, cotton, jute, and sisal.

2) Setting the prices for these commodities within what was called "equitable and remunerative" ranges--that is, prices above those that would be set by the forces of supply and demand.

3) Creating a $6 billion Common Fund to finance buffer stocks that would be used to maintain the prices set in the individual commodity agreements. A fund "manager" would maintain prices by selling those commodities whose prices were climbing above the agreed-upon ceilings and by buying commodities falling below the agreed-upon floors. Although the initial $6 billion would be guaranteed by the developed countries, the UNCTAD staff believed that funding would also come from some of the wealthy less developed countries (mainly OPEC), the World Bank, and private financial institutions.

4) Creating a "second window" to use some of the assumed profits made by the Common Fund to finance aid projects to help producers of eight nonstockable, noncore commodities to improve productivity, to create better marketing systems, and to promote diversification.

5) Indexing developing countries' commodity export prices to the import prices of manufactured goods exported by developed countries.

6) Establishing producers' associations, modeled on the OPEC oil cartel, to help insure higher prices for developing country commodities.

UNCTAD'S RATIONALE FOR THE IPC

The IPC was the centerpiece in the Third World's demand for a so-called New International Economic Order because commodities are central to the economies and development prospects for most of the developing nations. While a number of developing nations had made great strides toward industrialization by the mid-1970s, the vast majority of Third World nations were still dependent on commodities exports for foreign exchange.

For developing countries as a whole, commodity sales accounted for almost 80 percent of export earnings; in many cases, a few leading commodities might account for more than half a nation's foreign exchange earnings. Of the ten core commodities, 84 percent of the world's exports were supplied by developing countries with incomes below $900. On the other hand, 69 percent of these commodities were imported by developed states with per capita incomes greater than $1,500. Thus, higher prices for the core commodities would tend to transfer money from the developed to the developing countries.

Because developing countries need capital for investment and since most capital goods have to be imported, the amount of export income generated by commodities can be an important factor in determining the success of national development plans. When commodities fare well in the international economy, more resources for development are available. When commodities fare poorly in the international economy, development plans may be slowed, halted, or even turned back.

IPC advocates argued that commodities were not faring well due to three factors: (1) long-range trends in the structure of the international economy; (2) price fluctuations unique to commodities; and (3) political characteristics of the commodity trade.

On the first point, UNCTAD officials and delegates from the Group of 77 (a bloc of over 130 developing countries) argued that the long-run trend in terms of trade was going against the primary products produced by developing countries and in favor of manufactured goods produced by the developed countries. President Julius Nyerere of Tanzania pointed out that a tractor which traded for 15 tons of sisal in 1965 cost 46 tons of sisal in 1972. Thus, argued IPC supporters, the "magic of the market" was unjustly transferring resources from the poor developing countries to the rich, industrialized countries. The IPC would stop this, so supporters of the program argued, by raising, stabilizing, and indexing the prices for commodities of vital importance to the developing countries. In this way, resources for development would be maintained and increased.

Second, supporters of the IPC argued that the program would reduce fluctuations in the prices of commodities. From the first meeting of UNCTAD in 1964, Group of 77 delegates have argued that chronic fluctuations in commodity prices made economic planning difficult. If, for example, a country planned to invest a given share of its gross national product in development projects over a five- or seven-year period, sudden drops in the prices of commodities would mean shortfalls in foreign exchange, a lack of resources for investment, and consequently, unfulfilled development plans. Because the causes of these fluctuations usually lay beyond the control of the producing countries, in such phenomena as floods, frosts, or recessions in the developed countries, IPC advocates questioned the "justice" of an international economic order that "victimized" the poor and their carefully drafted plans for development.

A third argument in favor of the plan was political, for the IPC was designed to enhance the political power of the developing countries. In the past, international commodity agreements were always negotiated between the consumers and producers of the particular commodity in question. Because the consumers were usually rich developed states and the producers were poor developing countries, and because past practice had always been that producer countries alone were responsible for financing any buffer stock schemes, the poor countries were usually in a weak bargaining position.

With a common fund financed largely by the developed countries, the developing countries could bargain more effectively; no longer would they have to bear the cost for funding buffer stocks. In addition, the common fund and integrated system would enable producers in different commodities to band together and make "cross-commodity deals" with developed country consumers. Thus, argued spokesmen for the developing countries, the IPC was necessary to help equalize the power of parties involved in commodity negotiations.

A FLAWED PROPOSAL

The IPC illustrates the serious problems in many UNCTAD studies and proposals. At a superficial level, the rationale for the program seems sound and plausible; its design and operation appear clear and simple. Careful scrutiny, however, reveals that the IPC was based upon untenable assumptions, oversimplifications, and a failure to consider consequences and implications. More specifically, the IPC and the rationale for it suffer from five basic flaws.

1. The Myth of Declining Terms of Trade

Economists have been unable to find convincing evidence that the terms of trade have been running against the producers of primary commodities as a group. Thus, a major problem that the IPC was designed to remedy does not exist.

The originator of the "declining terms of trade" myth was Raul Prebisch, a Latin American economist and UNCTAD's first Secretary-General. Prebisch demonstrated a decline in the terms of trade only because of the particular base year he selected--1950, the height of the Korean War boom and a year when prices of many commodities were at their all-time high.

When Prebisch first presented his views in 1964, little notice was taken of them. During the early 1970s, however, his thesis became a major issue in the debate between the developed and developing countries. In 1974, this controversy led to the creation of an UNCTAD group of experts, the so-called Houthakker Commission, whose tasks were to explore the feasibility of indexing the prices of primary products and to determine whether or not the terms of trade had moved against commodities produced by the developing countries. The group was comprised of economists

from such disparate countries as the United States, Algeria, Poland, and Argentina. In 1975, this group reported unanimously that it could find no evidence to support Prebisch's thesis. It could not document the key premise of those who argued that the international economic system was rigged against the poor.[1]

The Commission did find considerable short-term fluctuation in the terms of trade between primary products and manufactured goods. They also identified particular products, such as tea and jute, that were experiencing chronic declining demand. But for the thesis that the prices of nonpetroleum raw materials, as a group, had risen less than the prices of manufactured goods, they could find no evidence at all.

The declining terms of trade thesis can only be demonstrated in one of three ways: (1) by citing examples of particular products that have declined, such as Julius Nyerere's example of jute and tractors, and ignoring counterexamples such as hand calculators becoming much cheaper relative to copper; (2) by choosing commodities whose prices have declined and ignoring commodities whose prices have increased; or (3) by choosing as the base for computation some year, such as 1950, where the prices of primary products were at the high point of a fluctuating curve.

The trouble is that the lesson of UNCTAD's own blue-ribbon commission had little impact on the UNCTAD Secretariat. In his first Trade and Development Report issued in 1981, Secretary-General Corea continued to use 1950 as a basis for his discussion. He also selectively compared highs to lows and ignored long-range trends.[2]

2. The Myth That Price Fluctuations of Commodities Hinder Economic Development

While most commodities experience continual price fluctuations, there is no evidence that these swings have affected negatively the investment or development plans of developing countries. Obviously, if the myth were valid, those developing countries whose products experienced the greatest fluctuations in price should have grown at slower rates than countries whose products experienced smaller fluctuations. Yet economists researching this subject found no such relationship between price fluctuations and national growth rates.[3]. In what is perhaps the most extensive such study, two economists from the University of Pennsylvania could find "no evidence that fluctuations in prices, as compared

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1 For a discussion of this commission, see Edwin L. Dale, "Idea of Growing Disparity in World Prices Disputed," New York Times, May 25, 1975.

2 See G. Corea, Trade and Development Report, 1981 (New York: The United Nations, 1981), UNCTAD Doc. TD/B863/Rev. 1, Sales No. E.81.II.D.9.

3 See, for example, A. MacBean, Export Instability and Economic Development (Cambridge: Cambridge University Press, 1966).

to a smooth path of prices, have substantial impact on economic performance as measured by capacity utilization or growth."[4]

One of the reasons why there is no relationship between price fluctuations and economic growth lies in the simple fact that the price fluctuations take place along a trend line. While there are downswings from the trend line, there are also upswings, and over the longer term, the downs and ups cancel out. A rational planner will base plans on the trend line and use savings in the good years to offset the downfalls in the "bad" years. What will not work are income projections based solely on the "high years."

Obviously, no planner can predict perfectly. Consequently, in the early 1960s the International Monetary Fund created a compensatory financing scheme which allowed nations to borrow against their quotas to cover export income lost because of short-term price fluctuations. These loans are then paid back with income gained in "good" years. This IMF fund has been liberalized on numerous occasions over the past twenty years, but never to the satisfaction of the Group of 77. What the latter is seeking now is a fund that covers declines in export income, whether from commodities or any other source.

3. The Simplistic Nature of the Common Fund Scheme

When the scheme for the Common Fund was unveiled, representatives from developed countries discovered that its sponsors had failed to address a number of crucial questions, which would have to be settled before it could operate. Among them:

- Which countries would contribute how much money?
- How many stocks would be held and by whom?
- How would interest and storage costs be determined, and how were these costs to be factored into the scheme?
- How would floors and ceilings be set?
- Who would decide to release the stocks and by what magnitudes?
- What would the formal-legal structures be?
- What voting arrangements would exist?
- How would benefits be distributed among developing countries?

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[4] F. Gerard Adams and Jere R. Behrman, Commodity Exports and Economic Development (Lexington, Massachusetts: Lexington Books, 1982), p. 294.

- Which nations would gain and which would lose?
- Which commodities would benefit and by how much?
- How much would developed countries that produced core commodities gain and from whom?

When asked for such details, supporters of the IPC responded that the developed countries must accept the IPC in principle and agree to underwrite the financing of the Common Fund. Only then would discussion on the details begin.

The failure of the UNCTAD staff and members of the Group of 77 to answer these questions led to studies by Western scholars and counterstudies by the UNCTAD staff. The most devastating blow to Corea's proposal came from a study done by Economics Professor Jere Behrman of the University of Pennsylvania. His work was commissioned by the Overseas Development Council, a Washington-based organization that generally supports the demands for a New International Economic Order.[5]

Behrman ran computer simulations of what would have happened to eight of the core commodities had the IPC been in operation from 1963-1972. He ran one simulation in which prices were stabilized in a band of plus or minus 15 percent of the trend line and another in which prices were stabilized at within 5 percent of the trend line. Using the 15 percent band, Behrman found that developing countries would have netted only about $540 million more per year in export income for all the eight core commodities. These gains would have come largely from higher prices paid by consumers in the developed countries.

For the decade as a whole, the gains would have varied significantly among commodities. While coffee, cocoa, and rubber would have gained over $6 billion, producers of copper and tin would have lost about $2 billion.

Behrman also found that the $6 billion proposed by UNCTAD for the Common Fund was much too low. To maintain the plus or minus 15 percent band against downward speculation, at least $10.4 billion would be necessary. To maintain the plus or minus 5 percent, even more would be needed. Gains for the developed countries, meanwhile, appeared largely in terms of forgone inflation--for the United States alone this could have amounted to about $1.5 billion a year.

Finally, the benefits of the plan would be scattered. Most would go to low-income (less than $299 per capita GNP) or lower

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5 Jere R. Behrman, International Commodity Agreements: An Evaluation of the UNCTAD Integrated Commodity Program, Overseas Development Council, October 1977.

middle-income nations ($300-$699 per capita GNP), although such higher income countries as Chile, Peru, and Brazil would also benefit. At the same time, some very populous Third World countries would receive few benefits. Among these would be India, China, Pakistan, Mexico, Colombia, and Argentina. All told, most of the meager benefits from the plan would go to countries containing a minority of people living in the developing world.

Behrman's study increased the recalcitrance toward the Fund proposal by delegates from developed countries and dampened the ardor of delegates from those Third World states that would not benefit from the fund--those that would actually lose because they were net importers of the commodities covered and those whose commodities would be used to shore up the declining commodities of other nations.

Delegates from developed countries balked when they heard that more than $10 billion might be necessary to fund the scheme. Among the Third World states, Argentina opposed the IPC because it was a net importer of the commodities covered by the fund. Chile and Colombia, copper and coffee exporters respectively, felt that they could secure better prices for their commodities by working within their own commodity groups instead of an UNCTAD-administered system. El Salvador, a country with strong coffee interests, supported the IPC, but opposed having coffee included in the program.[6]

As a result of Behrman's and other studies, Western suspicions and opposition to the plan hardened, while faith in the good will, neutrality, and competence of the UNCTAD Secretariat declined.

4. The Cruel Hoaxes of "Remunerative" Prices and Indexing

One motive underlying the IPC was the hope that the developed countries would allow other commodity groups to do what OPEC unilaterally did for oil--to create cartels restricting output, controlling supplies, "managing" markets, and, thereby, obtaining higher prices. Once such "remunerative" prices were obtained, they would be indexed or tied to changes in the import prices of manufactured goods produced in the developed countries.

When UNCTAD officials proposed the IPC, the OPEC experience seemed to demonstrate the feasibility of raising prices above market levels and indexing them. What too many ignored were the unique conditions that allowed OPEC to raise oil prices 500 percent;

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6 These positions of Latin American nations are taken from Jeffrey A. Hart, The New International Economic Order: Conflict and Cooperation in North-South Economic Relations (New York: St. Martin's Press, 1983), Chapter 4. Hart's study surveys only the positions of the Latin states. Studies of other developing states on the IPC are needed.

oil was perhaps the most vital resource for the developed countries; demand for it was exceeding available supplies; and there were no near-term substitutes for it.

Without such conditions, remunerative or above market level prices are not in the long-term interest of producers. For commodities with declining demand curves, such as jute, tea, and rubber, remunerative prices will simply encourage increased output from new or existing producers and thus lead prices to collapse. For commodities that are not experiencing declining demand, above equilibrium prices will encourage increased production, the use of substitutes, the development of synthetics--or all three.

For all kinds of commodities, remunerative prices encourage the misallocation of investment into the production of commodities, and thereby encourage developing countries to remain producers of primary products. Finally, OPEC's current troubles illustrate that, even in such a vital resource sector as oil, above equilibrium prices led to greater production, frequently from new producers, and the development of substitutes.

Indexing the new remunerative prices to the import prices of manufactured goods would only compound the problems caused by the remunerative prices in the first place. By further escalating prices in the short run, indexation would encourage investment in and overproduction of primary products. Indexing would also increase inflationary spirals and spread their ill effects to developed and developing countries alike.

5. <u>The Myth That "a Lack of Resources" is the Primary Obstacle to Economic Development</u>

Even if every aspect of the IPC worked as its founders intended, it is not clear that the increased income transfered to the Third World would spur greater development. While many developing nations obviously need more funds for investment, resources alone will not lead to development. In the world of UNCTAD, however, this question cannot be raised.

The basic UNCTAD philosophy is that substantial resources are owed to the developing countries and that these resources should be distributed without any consideration of whether or not they will be used wisely or foolishly. The IPC and the Common Fund fit this philosophy perfectly, precisely because the resources transfered through stabilized and higher commodity prices would be distributed on the basis of how well "geography" had endowed various nations with good climates and natural resources--the elites in countries with commodities would increase their largess; countries that were net commodity importers would become poorer. In no way would there be any relationship between the amount of money transfered under the IPC and a nation's record of accomplishment in the area of development.

In 1977, for example, Zaire's coffee crop was valued at $400 million. Due to smuggling and underinvoicing, only $120 million ever found its way into Zaire's treasury. According to David Lamb, former correspondent in Sub-Saharan Africa for the Los Angeles Times, "the rest ended up in foreign bank accounts held by Mobutu [the President of Zaire] and his Gbande colleagues."[7] The lesson here is that higher prices for commodities would not necessarily transfer income from the rich in developed countries to the poor people in developing states. Since the elites control the commodities in the Third World, they probably would be the main beneficiaries of the transfer. Their impoverished countrymen might gain little.

Because many primary products are used in roughly equal proportions by people in the developed countries, higher commodity prices are like regressive taxes--they fall more heavily on the poor than on the rich. Thus, schemes that raise the prices of commodities above market levels are really international taxes that transfer income from poor people in the rich countries to rich and well-connected people in the poor countries.

CONCLUSION

In sum, UNCTAD's centerpiece in the New International Economic Order, the Integrated Program for Commodities, was ill-conceived and flawed. Terms of trade have not been declining. Instabilities in commodity prices have not hindered economic growth and development in Third World nations. Problems created by short-term downfalls in commodity export income can be dealt with much more easily and cheaply than by the creation of a $10 billion Common Fund.[8]

When detailed questions were raised about the Common Fund, UNCTAD's proposal was immediately revealed to be more a wish or a hope than anything else. Moreover, even if the details of a Common Fund could be agreed upon, its benefits would be small and randomly distributed.

Studies by independent economists reveal that remunerative prices and indexation are a mirage. Schemes that indiscriminately transfer more funds to wealthy elites in the developing countries ignore the fact that people make development happen and that money alone does not and cannot.

The most devastating criticism of the IPC, however, is that it builds a Leviathan to deal with a problem that could be more simply handled. By focusing attention on this unnecessary

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7 David Lamb, The Africans (New York: Random House, 1982).

8 The IMF's compensatory financing facility is adequate for handling such fluctuations.

Leviathan for almost five years, the energies of UNCTAD's Secretariat and UNCTAD delegates were diverted from the most important issues facing leaders of the less developed countries--how to increase their production of wealth and how to diversify their economies and create new exports.

The key determinants of growth and development in both the developing and the developed world are people and governments--people who are willing to seek opportunities and create more wealth and governments that keep rules impartially and stay out of the way of the wealth creators.

What UNCTAD officials will never concede or acknowledge is that certain "roads" to development have been demonstrably more successful than others. The developing countries that have done well in the past twenty years tend to be those countries that have relied upon individual initiative, entrepreneurship, basic education, the use of relatively free markets and prices to allocate resources, an openness to international investors, and a willingness to engage in the risks and opportunities of the international market. The nations that have not done so well have relied upon planning, directives, subsidies, price controls, nationalization of foreign investment, parastatals, and international bartering.

The ideology promoted and preached by UNCTAD is the ideology of those developing nations that have failed, and the IPC reflects this failed philosophy. Bureaucratic planning, the creation of cartels, the abolition of prices and markets as signals to producers and consumers, and placing restrictions on output--these are the hallmarks of the IPC and the stock-in-trade of UNCTAD officials. And underneath it all is a naive belief that nations can grow, develop, and prosper by producing less and receiving more in return.

The IPC and the incessant demands for its adoption reveal the thankless task of U.S. representatives at UNCTAD meetings--that of persuading Third World delegates that support of such schemes is against the interests of their own nations.

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