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"Economic relations between Eastern and Western European countries
and the challenge from the developing world"

by

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This is a discussion paper not intended for publication or quotation.

Economic relations between Eastern and Western European countries
and the challenge from the developing world*

The conflict between developing countries and the industrial world has been a characteristic feature of the seventies. Although some industrial countries, both among centrally planned and market economies, have accepted the notion of a New International Economic Order (NIEO) as requested by the Group of '77, the objective contradiction has not been solved in any significant way.

At the same time, the late seventies witnessed a sharp deterioration in the détente process. Numerous elements point to the conclusion that the two developments - the conflict between North and South and the deterioration in East-West relations - are not unrelated. Some people believe that either one or the other of the two superpowers is deliberately pursuing an aggressive and expansionist policy, thus endangering worldwide peace. Although it is possible to detect such tendencies in both superpowers, we prefer to believe that both the USA and the USSR are still basically interested in peace. The deterioration in their relations should therefore be explained by developments taking place in the developing world. These developments are not originated by the superpowers and escape their control. At the same time they might endanger the security system or the economic prosperity of the superpowers. They are thus perceived as a threat which the other side is taking, or might possibly take advantage of, even if this is seldom the case.

* Note: Throughout this paper whenever the term "Western Europe" or "EC" is used, it is meant to exclude the USA. When the intention is to include the USA, I use either "OECD" or "West". Equally, "Eastern Europe" or "Eastern European countries" is meant to exclude the USSR. When the USSR ought to be included, I use "CMEA" or "East".

These considerations, which we do not intend to discuss in detail in this paper, led us to the conclusion that a new basis for détente should be created by approaching North-South problems in a cooperative way between East and West. In the pages that follow, I shall propose some considerations on the practical meaning of this statement.

Until now we have instead been accustomed to the idea of competition (not always peaceful) between East and West to gain the friendship of developing countries. It might therefore appear unrealistic to propose cooperation. Also, the countries of Eastern Europe have always maintained that the requests of the developing world are not directed to them, but only to countries belonging to the OECD. This contention has been repeatedly challenged in UN forums by representatives of the Group of '77.

Today the economic consequences of conflict in North-South relations are being felt by the Eastern European countries as well. Indeed, a further feature of the international economic system in the 1980's is the high level of interdependence. Developments in one group of countries - be they developing or industrial market or centrally planned - affect all other groups. The seventies have shown this very clearly, witnessing the fast spread of economic difficulties from one sector to the other and from one region to the other, so that by the end of the decade all countries without exception were feeling the pinch of the worst economic crisis since the end of World War II.

The obvious conclusion is that, while in some instances underdevelopment might historically be the responsibility of some, but not all, industrial countries, politically each and every countries has an interest at stake in the solution of North-South problems.

The new dimension of interdependence is therefore the political basis for cooperation between countries in Eastern and Western Europe for the solution of North-South problems.

If the need for such cooperation is overlooked, there is the danger that contradictions might arise between the development of East-West economic relations and the solution of North-South problems. Because experience proves that it is impossible to pursue détente in the presence of persistent North-South conflict, these contradictions cannot be solved by privileging the development of inter-European relations to the detriment of the developing world. Such a course of action would eventually be blocked by the crisis of détente, which is the necessary political prerequisite for the long term expansion of economic intercourse between East and West.

1. The North-South conflict found its most evident expression in the manifold increase in the price of oil. This increase took place while at the same time a number of developments made the logistics of international oil flows much more rigid and vulnerable - the two aspects being related.

Oil is also the clearest example of the extent of today's interdependence. A number of countries tried to "isolate" themselves from the oil shock, but only succeeded in delaying its impact. The United States introduced regulations on oil prices in order to prevent an increase in the price of domestically produced "old oil" which have now been abandoned. CMEA countries did not take into account international price increases until 1975, but were obliged to do so thereafter although gradually. No country or group of countries can afford to ignore the new international oil prices.

Energy is one field in which East-West cooperation is obviously needed in many different ways. Western Europe imports energy from CMEA, mostly from the USSR. This has raised a number of objections on the part of American commentators, which, however, should not be accepted. Access to CMEA sources of energy allows Western Europe to diversify her

sources of supply and therefore acts as a stabilizing influence. Western Europe should cooperate on the development of new energy sources in Eastern Europe and the USSR.

At the same time this is probably not sufficient to bring greater stability to the international oil market. Whatever the future of energy supplies within the CMEA, it is in the best interest of Eastern European countries that the international oil situation be more stable - if for no other reason than because each sudden jump in the price of oil precipitates Western European economies into a recession.

What is needed is some kind of international agreement in which both oil producers and consumers would participate, regulating access to oil resources, ensuring adequate supplies for the global needs, and establishing some stability and predictability in the behaviour of oil prices.

Such an agreement is politically unfeasible if the CMEA countries do not join the OECD in an effort to gain acceptance for it from developing countries at large, and OPEC in particular.

Within such an agreement, the issue of oil logistics could be dealt with, by agreeing on the existence of an international interest for all essential oil transportation infrastructure and sea lanes. This would diffuse current fears, which arose following some recent developments in the proximity of the Strait of Hormuz.

2. The oil problem is however only one aspect of a more general issue in North-South relations. Throughout the last two decades, developing countries have stressed their right to unrestrained national control over the natural resources included within their boundaries. This was a political reaction to the domination of foreign interests and multinational enterprises, which led to exploitative, sometimes ruthless, practices. As such, it was politically backed by numerous governments and political forces in the industrial world, both in the East and the West.

This political trend is however leading the world towards a dangerous situation. Investment in the development of mineral resources has stagnated in recent years. The continuing growth in demand is leading to increasingly tight and rigid supply conditions. The dependence of Japan and of the European countries (again, both in the East and the West) on imports of raw materials is essential. Some developing countries are dependent on imports as well, and share an implicit threat.

This situation is leading to political conclusions which are dangerous. Because of the concentration of mineral resources in Southern Africa, Western governments are somehow obliged to provide the racist regime in Pretoria with greater political support than they would otherwise. Some observers in the West analyze direct or indirect Soviet presence in countries such as Angola, Mozambique, Zambia, and reach the conclusion that the USSR is trying to choke the USA and, even more so, Western Europe by cutting essential mineral supplies or, at least, exerting political control over them.

These opinions should not be taken lightly. They might have great political impact and lead to dangerous options. The degree of preoccupation in Western Europe is shown by the multiplication of national programs to establish strategic stockpiles.

Sooner or later, we will have to recognize that the international community has a right to stable and sufficient supplies of raw materials, and the country within whose boundaries those materials lie cannot deny this right. Procedures must be established to agree periodically, at the international level, on minimum quantities to be supplied to the international market and maximum prices to be charged. If such an undertaking were not fulfilled, importing nations might refer the matter to the United Nations. The acceptance of this principle requires cooperation of East and West, and would do a lot to create a better climate for détente.

It is important to stress that one step in this direction has already been accomplished with negotiations for a Law of the Seas. The international regime governing sea bed mining in international waters is a positive indication, even if the extension up to 200 mi. of the definition of national waters goes in the opposite direction.

3. This line of reasoning leads us to a more general consideration, concerning the functioning and effectiveness of international organizations dealing with economic affairs.

It is difficult to conceive any positive development towards a New International Economic Order which would not imply a greater role for international organizations specializing in economic affairs. Indeed, some approaches (such as the RIO report) consider the development of a complex institutional set-up at the international level as the essential element of a NIEO.

On the other hand, existing organizations within the United Nations system (with the exception of the IMF and the IBRD, to which we will come back later) have a very poor record of effectiveness. This disappointing state of affairs is due to numerous reasons, among which the lack of political will from some key countries and the unrealistic voting rules. Both aspects are obviously very sensitive; nevertheless it appears that negotiations to ensure greater effectiveness of these organizations are necessary to base the détente process on firmer grounds.

There are two aspects to this question. First, East and West should agree on the importance of achieving greater effectiveness and on the principle of normally abiding to the regulations which are approved within international bodies. Second, East and West should initiate global negotiations to reach an agreement on modifications to the voting rules which would make the first point politically viable.

4. Although not everybody agrees on this, we believe that détente must include a strengthening of economic cooperation between countries belonging to the East and the West, particularly so in the European context. There is however a danger that the development of such cooperation be to the detriment of the developing countries.

As far as trade is concerned, this issue depends mostly on the commercial posture adopted by the Eastern European countries. The latter are making an effort to increase their exports of manufactures to the EC. This effort is an essential element within a strategy based on imports of technology and machinery from EC countries, financed by the latter through government loans or the Eurodollar market.

It is possible that exports from Eastern Europe end up by competing with exports coming from some developing countries. Available "market space" within Western Europe is limited because of social problems connected with the displacement of workers from one industry to the other, and even more so at times of sluggish growth. It is to be realistically assumed that, faced with excessive competition, EC countries would attribute priority to their relations with the Eastern European countries, to the detriment of the developing world. This, however, should be a matter of concern for the Eastern European countries, because inevitably critics of the economic implications of détente would voice their opposition louder and with better arguments.

In order to avoid this danger, the Eastern European countries should carefully plan the nature of their manufactured exports to the West, so that they are not competing with the exports of developing countries. There is no reason why this should prove to be unfeasible.

At the same time, it is important that the Eastern European countries make an effort to develop their trade relations with developing countries. Right now, all developing countries push their exports on the same limited geographical markets: the EC, the USA, to a lesser

extent Japan. While this is understandable as a first step, one must recognize that there is no reason for overlooking the possibility of developing horizontal trade between developing countries and the centrally planned economies.

This is valid for exports to the developing countries as well as for imports from them. The best guarantee that developing countries will cease to be "dependent" is increased competition between alternative potential suppliers of technology and machinery. Eastern European countries could certainly compete more aggressively on the markets of the developing regions; there is, furthermore, no need to assume that this trade should take place in non-convertible currencies, so that it might contribute to the financial position of Eastern European countries as well as exports towards the OECD.

EC countries should recognize that they have an interest in the development of trade between their Eastern partners and developing countries, and establish appropriate financial instruments to encourage this development.

5. Competition between Eastern European countries and the developing world is possible also at the financial level. Both groupings rely on the same sources of finance (the Eurodollar market, national export credit schemes). Although admittedly liquidity has been abundant on the Eurodollar market in recent years, this might not always be the case in the future.

However, this is not a sufficient reason to conclude that the Eastern European countries should reduce borrowing on the Eurodollar market, or generally rely less on external financing. The issue must, in fact, be seen in the context of global financial problems and flows.

Because balance of payments disequilibria have become persistent in the '70s, a solution must be found to the problems raised by the structural, long term payments surpluses of some countries. The question

is: which countries will accept deficits offsetting those surpluses? In recent years, the issue was settled by the capability and willingness of industrial countries to bring their payments back to balance, while developing countries were not in the same position. Thus the latter borrowed most of the funds channelled through the international financial market by the surplus countries. This created a level of financial exposure which is considered very dangerous by most observers.

Clearly, this state of affairs is unacceptable. One solution is that industrial countries accept to play a more active role, i.e. borrow on the international markets and: (1) accept a deficit in their payments; (2) increase aid and export credit to the benefit of the developing countries. This course of action would give a greater stability to international markets, because industrial countries are better risks; and would improve the position of developing countries because the growth of industrial markets to which they export would not be compressed to the same extent, *coeteris paribus*; and because development aid or export credit is generally cheaper than borrowing on the international markets.

If these elements are considered, then the appropriate conclusion to be drawn is that the Eastern European countries should actively participate in this effort, not by reducing their borrowing on the Euromarkets, but by increasing their financial assistance to the developing world.

6. A second solution to the problems mentioned in the previous paragraphs is the strengthening of international financial institutions like the IBRD and IMF. Indeed, throughout the '70s the role of these two institutions has been considerably increased, if measured by the amount of financial intermediation that they are able to undertake. If, however, these figures are compared with the growth of alternative financial intermediaries, such as the Eurodollar market, it appears that the relative weight of the IMF and IBRD has been reduced.

What is even more important is that the Brettons Woods system is now dead, and that many of the rules which were agreed upon in recent years are a thin cover over what amounts to substantial disagreement on the shape of an international monetary and financial system within the framework of a NIEO.

Voting regulations within the IMF and IBRD have allowed these two institutions greater effectiveness, but at the same time they have sometimes limited their political acceptability. The fact that the USSR and most of her allies chose to stay out of these institutions automatically conferred on them a markedly 'Western' character, which they should not have. Both institutions have been accused of being instruments of Western domination over the developing world - something which might have been true in the past, but is less and less so today.

The evidence is, nevertheless, that the world needs an effective international monetary and financial system. Such a system must provide greater stability and security, and in order to do so must be truly universal. It is now becoming clear that regional monetary and financial agreements will grow in importance in the future, and that at the same time a global system connecting regional arrangements is necessary because the dimension of interdependence is today global.

Such a system could well be negotiated within the IMF and IBRD: there is indeed, no reason to look for alternative institutional arrangements. A prerequisite is, however, that these institutions become universal, i.e. that CMEA countries become members.

I am convinced that a critical reexamination of the reasons why these countries chose to stay out at the beginning would show that they are today irrelevant - if for no better reason, because the rules are much less binding. At the same time, new developments, prominent among which is the active presence of CMEA countries as borrowers on international financial markets, provide fresh interest for these

countries to participate in deliberations which might deeply affect their economic planning and stability.

7. A further point on which some discussion might be useful is the issue of regional integration among developing countries. Given the limited territorial, demographic and economic dimension of these countries, regional integration is oftentimes a prerequisite for economic development (at least if dependence on some outside power is to be avoided).

Unfortunately, most attempts in this direction have failed. There are, of course, numerous reasons for this failure, among which the one we are interested in is the divisive attitude often adopted by both superpowers, by former colonial countries and sometimes other countries as well. Both East and West have consistently paid greater attention to securing "friends" within a region than to creating political and economic conditions conducive to regional economic integration. The Arab world provides striking examples of such behaviour.

Lately, a number of individual developing countries, belonging to disparate regions, have become members of the CMEA, or agreed to a preferential relationship with it. This is a puzzling development which raises the question: is this an implicit limitation of CMEA development efforts to these countries, or is it an attempt to relatively increase the weight of relations with the CMEA while relatively reducing regional relations? In both cases, it is a source of concern.

8. In recent years, industrial cooperation has become the most interesting segment of East-West economic relations. It is increasingly clear that there are limits to the growth of trade if this is not accompanied and supported by industrial cooperation.

In some instances, industrial cooperation between East and West has taken the form of tripartite or trilateral cooperation, involving

some enterprise or government body from a developing country.*

In the logic of this paper, such tripartite cooperation is extremely important, and should be encouraged. Special financial institutions or facilities might be created to this end; alternatively, tripartite industrial cooperation projects might be considered preferential by bilateral development assistance organizations.

The suggestion about creating special institutions or funds to foster tripartite cooperation acquires fuller meaning if we consider the sectors to which tripartite cooperation might better apply. The development of domestic energy resources is one sector that might be strongly favourable to tripartite cooperation; large scale infrastructure building is another one. Some crucial programs might be undertaken within such a framework. A European development facility, encompassing both Eastern and Western European countries, might command the creditworthiness necessary to borrow large sums on international markets, the technical and industrial capability to carry out large scale projects, and the appropriate political profile to overcome difficulties in sensitive projects, such as both infrastructure and energy-related projects sometimes are.

* See: S. Sideri, East-West-South Relations: The emergence of a more realistic international cooperation - mimeo discussion paper, The Hague, October 1980.

9. Before closing, allow me to anticipate two possible objections.

First, in the previous pages I laid stress on steps which Eastern countries ought to consider, but mostly ignored what the EC should do. Sure enough, this is not to imply that the EC has done or is doing all that was needed from her. Indeed, we are all aware that the burden of North-South problems will increasingly weigh on the EC's shoulders; and most of us would agree that the EC has not made enough of an effort in favour of establishing a NIEO. However, my point is that the EC will not improve her performance if the East-West situation deteriorates, and if the East does not move parallelly, along one or the other of the possible paths that were discussed in the previous pages.

It is important to recall that, notwithstanding some deficiencies, the EC has developed very positive relations with large sections of the developing world. Many developing countries look forward to an expanded EC role within the North to create political conditions conducive to a NIEO. However, East-West tensions have the immediate result of pushing Western Europe to close up ranks with the USA, and make EC initiatives in the North-South dimension much more difficult. In extreme cases, the readiness of Western European countries to provide assistance to the developing world might fall sharply if a feeling of encirclement grows; a tendency to establish a military presence in some key areas might prevail.

Second, it is unrealistic to think that in the present political and economic conditions the Eastern European countries will move along the lines suggested above.

If reference is made to the set of proposals as a whole, I agree that its adoption is not for today; but the purpose of this paper is to stimulate discussion, not to serve as an agenda for actual negotiations.

However, if reference is made to each individual proposal, then I do not see why they should be unrealistic. Agreements have been signed on issues, such as human rights, (Helsinki), which are much more controversial than the ones put forward in the previous pages. Proposals are tabled in Madrid to negotiate issues as difficult as disarmament in Europe; elsewhere negotiations have begun in view of a Salt III. Even tighter "confidence building measures" might prove more difficult to negotiate than membership of CMEA countries in the IMF or IBRD.

Days ago, President Giscard pronounced détente dead and called for "stabilization". Détente might be dead or alive, but destabilization certainly originates mostly along the North-South axis. It might be more important, in terms of confidence building, that we move along the lines proposed in these pages rather than establish new complex procedures for advanced notifications of military exercises close to the Urals.

The important thing is to recognize that there is a North-South dimension to East-West relations.

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