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Developing Countries

The Nixon Revolution and the Third World

by Professor W. M. Scammell, Hamilton, Ontario *

In the dramatic events and the whirl of talk which has followed the Nixon economic measures, the developed countries have been preoccupied with the new situation created for them. The ultimate impact of this fundamental policy-change upon the poor two-thirds of the world has been virtually ignored.

For years already the position of the Third World in the international economy has been deteriorating. Let us consider briefly the situation as it appeared to the developing countries at the end of 1970: the failure of the 1968 UN Conference on Trade and Development to create new trade policies conducive to development; the stagnation of GATT and the failure of the rich countries to find a new initiative in the movement for trade liberalisation. Indeed, the consciousness that not only had the drive for trade freedom lost momentum but that it was being replaced by a renewed protectionism (expressed particularly in import quotas and non-tariff barriers to trade) which impended a movement away from international economic cooperation towards economic nationalism and autarky. — All these were signs of deterioration in the general development prospect. As a background to the darkening trade situation, the so-called "crisis of aid" borne of the disillusionment of aid-granting countries with development attainments and the prospect of diminishing aid assistance gave cause for concern. The reduction by 10 p.c. of US foreign aid as part of the Nixon measures showed how real this mounting crisis is. The rejection of the whole American foreign aid programme by the US Senate in October 1971 came as the culmination of a series of threats to the economies of the Third World.

New Economic Environment

To this menacing trade and aid climate for the developing countries came the addition of the currency revolution wrought by the Nixon measures. A new international economic environment is about to shape itself and to it the developing

countries must adapt themselves. It is as well to consider just what the main features of this new environment may be. The main purpose of this article will be to assess the significance for the developing countries of the changes which have taken place.

We must not fall into the trap, at the outset, of seeing these changes as merely changes in the varying economic weather of the postwar period, of viewing them as we have viewed the inventory recessions of the US in 1949 or 1954, or the exchange rate problems of the British, or the liquidity questions posed by the German external surplus. They are of a different order of magnitude. They are changes not in weather but rather in the climate. We have witnessed in 1971 a complete reassessment by a number of super-powers — the US, the Soviet Union, Communist China — of their political relationships. What these new relationships may turn out to be, it is impossible to say at this stage. It is only possible to see that since Kissinger went to Peking and Nixon agreed to visit Moscow, since Britain decided to join the European Common Market and Red China was allowed to enter the United Nations, since Canada was refused exemption to the US surcharge and greeted Mr Kosygin as a welcomed visitor, the world has changed and with it have changed many of the old economic values. The old and now familiar-seeming world of the Western Alliance, the Marshall Plan, the Bretton Woods system and GATT has been exchanged overnight for a new and nebulous world in which new rules of the game will apply in every sphere, political and economic.

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For the Western powers the focus of change has been the United States. For that country, economic policy has, since 1945, rested upon:

- ☐ the pursuit of domestic economic stability through full employment and steady growth;
- ☐ the fostering of world trade by the vigorous advocacy of non-discrimination and the mild pursuit of liberal trade policies;
- ☐ the acceptance (since the mid-fifties) of a deficit in its balance of payments as the price it must pay for running a world key-currency;
- ☐ the maintenance of public sector capital export through aid programmes sponsored mainly, but not entirely, to canvass political support and cement strategic alliances and private sector capital export to establish a hegemony for American industry;
- ☐ and all this within the international monetary framework which we call the Bretton Woods system.

This has been the policy framework for thirty years. It spanned an epoch which began with the policies of Cordell Hull and Harry White and ended with Lyndon Johnson.

Domestic Objectives Prevail

How much of this has really changed? Domestically, if we interpret trends correctly and if we are to believe Professor Galbraith, the US has moved into the same syndrome of balance of payments deficit, economic stagnation and "creeping-to-running" inflation which has afflicted the British, the Canadians and other leading industrial powers in varying degree since the beginning of the sixties. The difference in the US case appears to be that it is not prepared to try to deal with cost-push inflation by prolonged bouts of monetary or fiscal deflation but has come earlier to the use of direct controls on wages and prices. Its success or failure in the domestic arena is not irrelevant for the rest of the world. Much of how American policy develops in the next year or so will be conditioned by success or failure in the domestic field, but it is with the external aspects of the "Nixon revolution" that the rest of the world is more immediately concerned.

If we sum up the external changes in policies we may see them as directing US economic policies primarily to domestic objectives even if this means alterations, some of them fundamental, in all of the former tenets of external policy. Already trade policies have become restrictive rather than expansionary. Already there are elements of discrimination and a rejection of

GATT principles in such policies. Already there are demands for changing the balance of payments deficit to a surplus, regardless of the effects upon other countries' balances and upon international liquidity. Already aid has been cut and measures to restrict overseas investment imposed. In the IMF and the Group of Ten the United States is no longer the moral leader but the defiant iconoclast.

It is natural to see the changes of US policy as the greatest aspect of the changing world situation. These changes alter the landmarks in the scene which has been familiar for a quarter of a century. We can already analyse these changes in terms of the disappearance of features long familiar to us. But the greatest aspects of change may still be unperceived and can be imagined at this early stage only in terms of questions. What may be the effect on world trade if the Bretton Woods world is replaced by a world system including the Soviet Union and China? The emergence into full trading activity on a wide front of these enormous countries must have enormous significance both for trade volume and trade structures to say nothing of payments. What would be the effect on a world payments system if the dollar problem which changed its nature once in the mid-fifties should change it again in the mid-1970's? Finally, lest the patient reader wearies from unanswerable questions, what may be the effect of all this upon the Third World, which it seems must wait supinely in the wings until events over which it has no control determine its fate?

Effects of Nixon's Surcharge

In assessing the immediate effects of the Nixon policies upon the developing countries let us turn first to the cut in aid of 10 p.c. and the imposition of the import surcharge.

The impact of the reduction in foreign aid is, at this juncture, hard to assess. The exact nature of the reduction has not been defined nor has its duration. Will it, for example, apply equally to all types of foreign assistance — to loans, gifts, export credit, military and non-military aid? No doubt the details of the constraint are only slowly percolating through the Washingtons bureaucracy. At the least and most optimistic, it might be a temporary check, the impact of which might be slight as later programmes take up the slack; on the worst assumption it might be the precursor of a whole new look at American aid programmes not only in relation to their size but in relation to new alliances, policies and strategies. The recent Senate decision, although

it was not prompted by the White House, gives weight to the latter view. Certainly even as a single reduction the 10 p.c. cut could not have come at a worse time. In fixed currency terms the per capita foreign aid (from all sources) has remained static for the past decade. The American measure may thus bring the first reduction in such aid since the postwar programme of assistance to developing countries began. Perhaps the greatest danger is that the American reduction might lead to a wider curtailment as other aid donors follow suit. There are few countries which meet the target of the Pearson Report—of providing one per cent of their GNP to help developing countries—and if we now enter upon a period of contracting trade the temptation for other countries to follow the American example will be great.

The impact of the 10 p.c. import surcharge upon the developing countries is sure to be detrimental. How detrimental will depend upon its duration, upon whether it is the first symptom of a new American protectionism, upon whether it triggers off retaliatory measures by other industrial countries and upon whether the 15 year long growth of international trade is now to be interrupted and replaced by contraction.

Manufactured Exports in Jeopardy

But already and without these threats the position of the developing countries is parlous. They have imported capital steadily since the fifties and the burden of servicing and repayment is now heavy upon their usual import surpluses. A sharp growth in exports is necessary in the coming decade even if they are to service their debts and hold balances of payments even at their present rates of deficit. A level of exports sufficient to support further development seems almost impossible. Even in the years of trade expansion, rates of export growth by these countries have been modest. During the period 1960-70 (when world trade grew at an annual rate of 8 p.c.) the Third World's share of trade fell steadily from 21.3 p.c. to 17.6 p.c. Even in the field of primary commodity trade—the staple of the poorer countries—the rate of growth at 5.6 p.c., was well below the world average. If world trade ceases to expand or even contracts, the poorer nations will be the first victims.

United States spokesmen are well aware of this. Ever since the 1964 UNCTAD meeting, at which the U. S. played an unconstructive role, they have been under attack and criticism for their failure to lead an initiative to open up trade for the developing countries. Since August 15 they have defended the US surcharge by arguing that, since the surcharge does not apply to primary

materials, 70 p.c. of the developing countries' exports will be unaffected. The implication here, that the effect of the surcharge on the remaining 30 p.c. is unimportant, is completely unfounded. The sales of manufactured and semi-manufactured goods by developing countries represent the effort of new and often struggling industries whose competitive position is poor. But during the past ten years these manufactured exports have registered (at 15.8 p.c. per annum) a higher rate of growth than the manufactured exports of the rich countries. Now all this is in jeopardy. Half of these exports go to North America, mainly the United States. The surcharge is a serious blow to their prospects.

Monetary Problems

A further change has taken place which is of great significance for the Third World — the transformation in the international monetary system. It is well to remember, too, this crisis is not of their making nor are they permitted any voice in the negotiations for its solution. The Group of Ten, on whose negotiations the first steps towards a new system depend, is a rich nations' club. The ten richest nations in the world and in the IMF will shape the new system; the Third World must accept it.

It is not possible here to consider the longer range aspects of the monetary problem. We do not know what the monetary scene will be even a year from now. What can be said with fair certitude is that the developing countries will have to live with two features, one of them endemic to their condition, the other dictated by the actions of the rich countries. The first is a shortage of international liquidity; the second is a world in which the main exchange rates are floating — not freely but each under the influence of its own monetary authority.

Since the shortage of international liquidity is not new to the developing countries and since the alleviations to it, through the IMF and the SDR system, are known and are unlikely to be changed in the near future we will not dwell upon this problem. Balance of payments deficits, shortage of reserves and resort to direct controls to ration scarce currencies are familiar features of developing economies and will remain so. If, however, the fears which have been expressed in earlier paragraphs are justified these difficulties will be intensified.

What are the implications for the developing countries of floating exchange rates? The answer is that it all depends upon the sort of developing country about which we are talking. Clearly for

countries such as Nigeria, the larger Latin American countries and the developing countries of south-eastern Europe, all of which have developed banking systems and established trade connections with richer countries, the floating exchange rates of the developed countries have greater significance than they have for small African, Asian and Caribbean countries whose financial system is primitive and who are prepared to manipulate their small foreign payments and reserves as best they can. This second group of countries share with all developing countries the duress of the so-called foreign-exchange constraint. It is hard to see that it will be greatly changed in the short period by the movements in the values of the great currencies. The continuing problem of obtaining international liquidity support for such countries which is at present served by the IMF will improve or worsen according to the changes in the IMF which may come from the present crisis.

For the first group of countries it is different. Each has a banking system, each has a currency which itself is bought and sold on exchange markets, some hold their banking reserves dominantly in one of the key currencies. Although the past quarter century has weakened this influence, such countries tend to be trade and financial satellites of larger and richer countries. India, Pakistan or Ceylon are examples. All are members of the so-called sterling area. They manipulate their currencies' rates in terms of the pound because it has been their main trading currency. They hold at least part of their reserves in the form of sterling balances in London. The past two decades have seen a weakening of this system partly because such countries have widened their trading horizons, partly because the pound with two postwar devaluations in 1949 and 1967, seemed to be a dangerous vehicle for holding reserves — despite a recent gold guarantee agreement. A system of fluctuating rates for the main currencies, if it persists, will probably revive the currency areas. Developing countries of this type will stabilise their currencies in terms of the pound, the franc, the dollar and perhaps the D-mark. The sterling area, dollar area and franc

area may be powerfully revived if free rates persist for long.

Danger for World Multilateralism

The emergence of such arrangements would have two consequences; one somewhat undesirable, one beneficial. The undesirable aspect would be that, since currency areas tend to force members to trade for preference with other area members, the multilateralism of world trade is impaired. In brief, currency areas involve some built-in discrimination and to this extent may constrict the total volume of world trade. The desirable effect would be to limit the number of effective exchange rates in the floating market. In a currency-area-world rates within each currency area are fixed while the floating rates between the main currencies govern the cross-rates between the satellite currencies in different areas. This is a preferable situation, making for a more orderly exchange market, as compared to the myriad rates and cross-rates resulting from individual uncoordinated currency values in a floating system.

This brief and highly speculative review of the effects of the Nixon "revolution" upon the economic position and prospects of the Third World is depressing. There is no single change which has been made or which is likely to occur which will redound to their benefit. Several clearly have the grimmest implications. Perhaps of all consequences the worst would be if the United States has indeed changed policies fundamentally, turned its back on the Third World and rung down the curtain on what some American idealists regarded as, in the long run, their country's finest contribution to the postwar world — the recognition of its responsibilities as the world's richest nation. Perhaps the most depressing feature of the Fund's Washington meeting in September was the fact that during the speeches of the giants of the Group of Ten, Mr Connally, US Secretary of the Treasury, was rooted in his seat listening attentively. During the speeches of most of the small, poor and politically unimportant countries his place was taken by a minor official of the US delegation.

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