1 The old and the new international economic order

NORMAN SCHOFIELD

The international monetary system

Towards the end of the Second World War representatives of Britain and the United States met to put together a set of international institutions which would be able to enhance the degree of co-operation on monetary and trade matters between industrial countries. The lesson that had been learnt from the 1930s was that, under certain circumstances, the policy objectives of individual countries could be mutually incompatible. Domestic considerations could force countries into competitive devaluation and increasing protectionism in order to increase export competitiveness and maintain employment. Of course such a strategy on the part of one country had damaging effects on others.

The purpose of the international system set up at Bretton Woods in July 1944 was to make it relatively easy for countries to move towards a position where their currencies were freely convertible and few, if any, impediments were imposed on free trade. To avoid the possibility of competitive devaluation, there was a preference for a system of fixed exchange rates which would also have the added advantage of forcing countries to follow 'responsible financial policies, because of the need to maintain balance of payments equilibrium' (Crockett, 1977).

At the same time it was realised that the weakened European countries would need assistance with temporary balance of payments deficits resulting from industrial reconstruction.

The plan for an International Stabilisation Fund called for two components: the Stabilisation Fund itself, with assets of $5 billion to
provide credit for countries with balance of payments deficits, and an International Bank, with assets of $10 billion to supply capital for reconstruction through long-term low interest loans. These twin institutions became the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD).

From the US perspective, the problem was to maintain a high level of exports to the European economies, so as to maintain high levels of US employment and growth. This could be done by using the lever of financial assistance to persuade the European countries to dismantle protective import controls. Keynes, the UK negotiator, favoured a non-interventionist clearing union, with resources of the order of $26 billion, which would facilitate European and particularly UK reconstruction, irrespective of US growth. Under the compromise Bretton Woods agreement, the UK was allowed to maintain protectionist currency controls for a transitional five-year period.

When Truman became US President after Roosevelt’s death in April 1945, greater pressure was brought to bear on the UK to dismantle the system of imperial preference. Countries in the sterling area pooled their dollar reserves, and this acted to reduce dollar expenditures by discriminating against US goods. US aid to the UK under lend-lease was terminated after the end of the war with Japan, and Keynes was dispatched by the Labour government to negotiate a $6 billion loan.

The condition for the eventual $3.75 billion loan was to reduce preference for UK goods, by eliminating the margin of preference for imperial trade, by wiping out the outstanding sterling deficits with various less developed countries (such as India, Egypt, and so on), and by a return to sterling convertibility.

By 1947 it became clear that some mechanism was needed to cope with the very large European trade deficit with the US. Without some such device, the European economies would have to reduce US imports. The Marshall Aid programme, unveiled at Harvard in June 1947, promised an aid flow of the order of $17 billion to Europe. This flow would facilitate the maintenance of US exports to Europe, would assist in the reconstruction of the European economies, and would therefore counteract the attraction of both the USSR and protectionist trade strategies.

The rush on sterling, induced by convertibility in July 1947, also made it clear that general convertibility of the European countries could not be expected in the near future. As a temporary expedient, the first Intra-European Payments Agreement went into operation in October 1948, to increase the degree of multilateralism in European trade.

In the US recession of 1949–50 some of Keynes’ fears were realised. British exports to the US dropped and her deficit with the US reached
$660 million. This raised the possibility that the UK would defend itself by closing off the Sterling Area. In fact the UK devalued by 30.5 per cent in September 1949, to be followed by Norway, Denmark and the Netherlands. It seemed that the competitive devaluations of a trade war were about to start.

To deal with the problem of the provision of international liquidity the US adopted a strategy of rearmament. Between 1950 and 1953 US defence spending increased from $13 billion to $50 billion, while US military aid increased from $0.5 billion (1950) to $4.17 billion (1953) and dropped to $1.97 billion by 1959 (Block, 1977). The US balance of payments increased from $0.57 billion (1949) to $2.16 billion in 1953. Although IMF resources were available after 1947, Marshall aid was initially viewed by the US as a substitute for IMF transfers. In fact IMF drawings only averaged $70 million between 1950 and 1953, and it was not until 1957 that they reached $1 billion.

To further facilitate multilateralism in trade, an agreement on a European Payments Union (EPU) was signed in September 1950. This was seen as a step towards the removal of monetary controls, and the full convertibility of the European currencies. US opinion favoured European integration since this was likely to strengthen the European economies through trade creation, and make less likely unilateral protectionist stances. In 1952 the European Coal and Steel Community (ECSC) was formed by the six countries of ‘little Europe’ – France, West Germany, Belgium, Luxembourg, Italy, Holland. A plan for a European Defence Community (EDC) had to be abandoned in 1954 because of French opposition. Under the Treaty of Rome in March 1957, the European Community and European Atomic Energy Community were created by the Six. By December 1958, the EPU was dissolved and the major European currencies became convertible.

Although a major step had been made towards an open world economy, there were signs that the reliance of this economy on the strength of the US and its ability to provide international liquidity generated certain contradictions. Throughout most of the 1950s the US had maintained a respectable trade surplus (except in 1953 and 1959) and a direct investment surplus. Government transactions (aid, military expenditure, and so on) were generally in deficit at about $3 billion, while there was a long-term capital flow deficit of about $0.5 billion. The US gross liquidity balance reached nearly $4 billion in 1960, and by this time foreign dollar holdings exceeded US gold reserves.

The Triffin (1960) dilemma was that the continued growth of the developed economies implied that demand for international reserves would grow faster than the supply of gold. Consequently a liquidity shortage would become apparent unless the US ran a continued balance of payments deficit. Eventually convertibility of the US dollar into
gold would become impossible to maintain, and the gold-dollar system would collapse. This dilemma lay at the heart of the problems that became apparent throughout the 1960s, and eventually killed the system in 1971.

The continuing US deficit meant a growth of private holdings of US dollars. At the same time as the fixed exchange rate system required a fixed rate of exchange between dollars and gold (then at $35 per ounce of gold), the power of short-term capital to threaten the official exchange rate was increased.

In 1960 higher interest rates in Europe stimulated the flow of short-term capital from the US. By October the price of gold in London had climbed to $40. To help the dollar, the European Central Banks agreed not to buy gold when the price rose above $35.25 (Strange, 1977). By October 1961 a buffer stock to manage the gold market had been set up with resources of $1.35 billion from the US and the same amount in total from the European countries. Before this, revaluation of the West German deutschemark and the Dutch guilder in March had set off a flow out of London. Under the Basle agreement the central banks agreed to hold each others currencies, rather than just gold and dollars, in order to offset the destabilising effect of ‘hot’ short-term capital.

Within the context of the Organisation for Economic Co-operation and Development (OECD), a group known as Working Party III, involving representatives of the major industrial countries, was set up to discuss monetary policy. Eventually this lead to the General Agreement to Borrow (GAB), with resources of $6 billion, pooled by the Group of Ten participants (US, UK, West Germany, France, Italy, Japan, Canada, the Netherlands, Belgium, Sweden). Although requests to draw under GAB went through the IMF the decision was to be made by weighted voting within the Group of Ten.

While some institutional arrangement such as the GAB was necessary to maintain monetary co-operation between the developed countries, the very existence of the Group of Ten or ‘Paris Club’ seemed to imply to the representatives of the developing countries that there were different rules for rich and poor. The UK had after all drawn $1.5 billion in August 1961 without strings. Nye (1973) has suggested that this contributed to the solidarity of the developing countries (the Group of 77 or G-77) in the first UN Conference on Trade and Development in 1964.

Throughout the 1960s, sterling seemed to act as a lightning rod for destabilising forces. After the Labour government came to power in October 1964 a sterling crisis, induced by a substantial deficit, forced the UK to obtain a $3 billion loan from the central banks together with a $1 billion drawing from the IMF through the GAB.

In May 1965 Britain drew a further $1.4 billion from the IMF. After
the re-election of the Labour government in March 1966, a credit squeeze was introduced to reduce the trade deficit, and Britain was able to repay its loans from the central banks. However the six-day Arab-Israeli war in June 1967, the rejection of the UK’s application to the European Economic Community (EEC), a dock strike in September, and the announcement of the largest trade deficit all contributed to the intensification of speculative pressure on sterling. On Saturday, 18 November the pound was devalued from $2.8 to $2.4. As Solomon (1977) has pointed out this ‘travail of sterling’ showed the damaging effect of speculative flows on a country whose currency had a role as a major reserve asset. The devaluation of sterling also undermined the par value system, since it became clear that a fixed exchange rate could not be maintained. Between November 1967 and March 1968 the gold pool was forced to sell $3 billion of gold to defend the gold dollar exchange rate of $35 per ounce. While this could not be allowed to continue, there were fears that further devaluation would bring about monetary chaos. The solution was a two-tier system, agreed on by the governors of the main central banks in March 1968, under which the US would continue to sell gold at $35 to monetary authorities but not to private agents.

In the four years between 1964 and 1968, reserves of gold and foreign exchange had declined by $4 billion. To maintain international liquidity, discussions took place in the IMF on the creation of a ‘supplement to existing reserve assets’ — the special drawing right (SDR). An outline proposal was approved at a Stockholm meeting in March 1968, and the required amendment to the Bretton Woods agreement ratified by 80 per cent of the IMF votes by July 1969. Perhaps the Stockholm meeting signalled the end of the gold—dollar Bretton Woods system.

Speculative pressure now mounted on the franc—deutschmark relationship. During the events of May 1968 French reserves fell by $300 million. France drew up to $1 billion under swap arrangements with the Federal Reserve in November and a further $745 million from the IMF under the GAB. By 1969 France had a $2.7 annual trade deficit. On the other hand, because of speculators’ belief in the imminent revaluation of the deutschmark, the Bundesbank took in $1.7 billion of foreign exchange in August, and a further $2.8 billion in November. However, with elections on the way in September 1969, West Germany had little inclination to revalue and hurt its export industries. Conversely, de Gaulle attempted monetary tactics other than devaluation. After the defeat of de Gaulle in the April referendum, West Germany indicated that though it would not devalue alone, it would in the context of a general realignment of exchange rates. In a few days in May $4.4 billion in foreign exchange entered West Germany. After a reserve
loss of $4.7 billion in the year to June 1969, France devalued by 11.11 per cent on 8 August 1969. In West Germany a Social Democrat – Free Democrat coalition government was returned after the September 1969 election, and on 24 October a revaluation of 9.29 per cent for the deutschmark was announced.

It seemed to many observers that the US had permitted these European alignments rather than face the cost of a major exchange rate change itself, and thus perhaps increased European hostility to the US position of 'benign neglect' in its role as the major reserve currency. The problem of disequilibrium was also exacerbated by the growth of the Eurodollar market. The growth of this market was not tied simply to the US balance of payments deficits but reflected the convenience for private capital in operating outside domestic restrictions (Crockett, 1977).

In 1970 US interest rates were reduced by Nixon in the face of the forthcoming presidential election. By December 1970 speculative flows had increased West Germany’s reserves to $13.5 billion. On 26 April 1971, Schiller proposed to the EEC finance ministers that the European currencies should be permitted to float up against the dollar. As a result in one hour on 5 May, $1 billion entered West Germany; eventually the deutschmark and Dutch guilder floated, while Austria and Switzerland revalued.

An OECD Working Party III report in July 1970 suggested that the monetary instability that was occurring was not simply due to the substantial private speculative flows. Having lost its complete economic dominance, the US could not legitimately refuse to accept the responsibilities that went with the position of providing the principal reserve currency. For 1971 itself the US trade deficit was to be $2.2 billion compared with a surplus the year before of $2.6 billion. Indeed the US had been in a steadily worsening deficit on consumer goods since 1959 and on foodstuffs since 1968, while the deficit on industrial supplies jumped from $1.3 billion in 1970 to $4.2 billion in 1971 (Block, 1977).

The package, announced by Nixon on 15 August 1971, included a 90-day freeze on rents, wages and prices, a $4.7 billion cut in Federal spending, a 10 per cent cut in foreign aid, tax cuts of $6.2 billion, and a 10 per cent import surcharge on 50 per cent of total US imports.

To deal with the speculators waging 'all out war' on the American dollar, the Secretary of the Treasury, Connally, was instructed to suspend, temporarily, the convertibility of the dollar. By the Smithsonian Agreement of December 1971, the Bretton Woods system of par values was finished.

Although the US hoped for a revaluation of the yen, to counter the substantial US trade deficit with Japan, the Japanese refused to comply, and took in $4 billion of foreign exchange in two weeks in order to
hold the yen at its dollar parity.

As the new chairman of the Group of Ten, Connally demanded concessions from the Europeans on trade, aid and exchange rates, sufficient to bring about a swing in the US balance of payments of $13 billion. The Europeans for their part wanted a small devaluation of the dollar against gold, rather than forced revaluations of their own currencies. By early October however the yen, deutschmark, Dutch guilder and even sterling were all above their par values.

At the heart of the disagreement between the US and the Europeans was the distribution of the OECD current surplus (then $11 billion) with the rest of the world. While the US wanted a surplus of $9 billion, the other OECD countries had a surplus of $8 billion (Solomon, 1977). At the meeting of deputies of the Group of Ten in Rome in November 1971, Connally threatened to devalue the dollar by 10 per cent. On 14 December in the Azores, Nixon and Pompidou agreed that the dollar would be devalued in relation to gold to $38 per ounce. At the Smithsonian Institute in Washington on 18 December the OECD currencies were revalued in relation to the dollar by amounts ranging from 16.88 per cent (for the yen), through 13.58 per cent (the deutschmark), to 8.57 per cent (for sterling).

Although the US had been successful in setting up a liberal economic order by the late 1950s, the contradictions that developed, during the 1960s, from the changes in relative economic strength between the US, Germany and Japan proved too much for the institutions like the IMF and OECD which had been set up to promote co-operation. While some of the negotiations took place under the auspices of the IMF, the form they took justified again Keynes' old fears that the growth of the world economy depended too much on the behaviour of the US. The developing countries had not been consulted during the negotiations; eventually they formed the Group of 24 (G–24) to press for their interests. As the Secretary General of UNCTAD observed, the developing countries held little of the world's gold reserves and obtained no benefit from the dollar devaluation vis-à-vis gold.

Throughout 1972 and 1973 there were continuous attempts to stabilise the international monetary system and reconstitute the Bretton Woods system of par values, but the oil price rises of October and December 1973 made all attempts hopeless. In an attempt to deal with exchange fluctuations, in March 1972 the six EEC countries set up the snake, an arrangement under which changes in their exchange rates with each other were kept to 2.5 per cent. The variation of 4.5 per cent with the dollar was the tunnel that housed the snake. In May 1972, Britain also joined the snake, but had to leave and float sterling in June as a result of intense speculative pressure. By February of the following year the dollar was devalued by 10 per cent, while in March the EEC
snake floated free of the dollar. Belgium and the Netherlands set up the *worm* in the snake — a 1.5 per cent exchange rate band, and the *deutschmark* revalued by 3 per cent. After using $3 billion of its reserves in the last half of 1973, France had to float free from the snake in January, 1974.

Negotiations for the reform of the international monetary system took place in the Committee of Twenty (C-20), formed in July 1972 and based on the twenty constituencies that appointed Executive Directors to the IMF. Any reform was made difficult because of the considerable differences of opinion among the industrial countries. However it was agreed to define the Special Drawing Right (SDR) in terms of a basket of currencies, and to set up an Extended Fund Facility (EFF) which would allow developing countries to obtain long-term assistance to help with balance of payments problems. To provide assistance with the effects of the oil price rises a special oil facility was created and the Compensatory Financing Facility or CFF (set up in 1963 to help countries with unexpected export earnings shortfalls) was extended.

The final report and the ‘Outline of Reform of the Committee of Twenty’ was published in June 1974, and emphasised ‘better international management of global liquidity with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced’ (Solomon, 1977). Although the ‘Outline’ also urged the promotion of net resource flows to the developing countries, the Group of 24 argued that their interests were not sufficiently addressed, and pressed for the *link* of extended SDR allocations to the financing of economic development (Williamson, 1977).

The McCracken Report (1977) observed that after the mild recession of 1971, the industrial countries reflationed more or less simultaneously. In the 7 major OECD countries overall unemployment dropped from 3.7 per cent in 1972 to 3.2 per cent in 1973, while the rate of change of consumer prices moved up from 4.4 per cent to 7.7 per cent. The Report saw a connection between the continued US payments deficits, the rapid increase of official reserves, and the expansion of money supplies. Monetary and fiscal policies which the Report saw as excessively expansionary are also linked to the bunching of elections in US, West Germany and Japan in 1972. (For a discussion of the so called political business cycle theory underlying this argument see Hibbs, 1981.) As a result of these policies GNP for the OECD group rose 7.5 per cent between the first half of 1972 and of 1973, while industrial production rose 10 per cent. Increased demand led to a raw material price boom. From the end of 1972 the terms of trade of primary products against manufactured goods rose strongly for the first time since the Korean war. *The Economist* index of industrial material prices

While the oil price rises of 1973 were in one sense part of this commodity boom, the increases were much more substantial and permanent than for other commodities because of the success of the oil producers' coalition. In the next section the formation and structure of this coalition, and its effect on both the international economic and political systems, is considered.

The oil crisis

The oil price rises of 1973 were the result of a complex combination of circumstances. While the general commodity boom created an environment within which price rises could be entertained, what was more significant was the historical development of OPEC (the Organisation of Petroleum Exporting Countries) and the ability of its members to preserve co-operation, in the face of the combined belief by many commentators that collapse was imminent. The reasons for the success of OPEC were partly to do with the increasing dependence, particularly of the US but also of Europe, on oil imports, coupled with an oligopoly system — the seven sisters — which had developed in the refining and marketing end of the business.

Total world energy consumption increased from 2.3 billion metric tons of coal equivalent in 1949 to 7.1 billion metric tons in 1971. In the US, oil as a percentage of all energy consumption increased from 24 per cent in 1949, to 42 per cent by 1960 and remained constant thereafter. In Europe this percentage went from 30 per cent in 1960 to 57 per cent in 1971. Although coal reserves were substantial in Europe (about 32 billion tons) the discovery of new oil reserves and the considerable drop in the real price of oil brought about an American style utilisation of 'energy factors' in Europe. In 1948 one-third of known oil reserves were in North America (that is, 20 billion barrels out of 60 billion: a barrel is 35 imperial gallons). By 1972 of the 640 billion barrels of known oil reserves, 350 billion were in the Middle East, 110 billion in Africa, 100 billion in the USSR and only 50 billion in North America (Vernon, 1976). Middle East output increased rapidly after the Second World War, and its distribution was essentially controlled by seven corporations — the seven sisters. Three of these — Exxon, Mobil and Socony — had been part of Standard Oil, which had been finally broken up in 1911. Two more — Gulf and Texaco — originated in Texas after Spindletop in 1901. Of the remaining two, Dutch Shell was formed from Shell and Royal Dutch in 1903, while British Petroleum (BP) developed out of the Anglo-Persian Oil Company. The com-
panies maintained co-operation amongst themselves by setting up concessions to extract and divide the oil, paying a royalty to the host country. For example the Iraq Petroleum Company (IPC), formed from BP, Shell, Exxon-Mobil and Compagnie Française Petrot (CFP), obtained concessions within Saudi Arabia, Iraq and Syria. The Arabian-American Oil Company (ARAMCO), formed from Socol and Texaco, Exxon and Mobil, developed the new finds in Saudi Arabia and Bahrein. By various means (Blair, 1976) the majors were able to ration production among themselves, while rapidly increasing production from low cost Saudi Arabia.

By the late 1960s, of a posted price of $1.80 the host government received 96¢ in royalty and tax, operating costs were 10¢, while the company took 74¢.

A relatively new producer, Libya, did not belong to the consortia system, and in increasing its output to over 3 million barrels a day, emphasised the granting of concessions to independent companies. By exerting pressure on the Occidental Oil Company Libya forced a price increase in 1970, and then took 51 per cent of various concessions. Libya also reduced output to 2.1 million barrels a day (mbd) by 1973. By July 1973 the posted price had increased to $3/barrel (with $1.78 for the host government). In October 1973 this price was raised to $5.11 and then to $11.65 in January 1974, along with an embargo which reduced world oil trade flows from 33 mbd to 28 mbd between September and November 1973. In 1974 the royalty rate was increased from 12.5 per cent to 14 per cent, and the tax rate lifted from 50 per cent to 80 per cent in some countries. In 1976 Venezuela nationalised all the concessions and eventually the other producers followed suit. The price rise had little effect on the majors since these increases could be passed on to the consumer. It is likely also that the various concessionary arrangements meant that the majors faced a crude oil price that was on average lower than that faced by the independent companies. It would seem that co-operation between the oil producers was enhanced both by the willingness of the majors to accommodate themselves, and by the consortia networks that had been set up. In addition to the demonstration effect that the Libyan strategy had on the other producers the degree of OPEC concentration in production had increased (with Iran and Saudi Arabia between them producing 43 per cent of OPEC output by 1972). Finally the relatively sudden failure of US autarchy in oil consumption (its overall imports increased to 6 mbd in 1973) must have contributed to the ability of OPEC to force the price up.

The effect of the 1973–4 price rises was to increase OPEC earnings from $14 billion in 1972 to $96 billion in 1974. Originally it was believed that the organisation would split up, because of differences
between the poorer countries (Ecuador, Indonesia, Nigeria, Iraq, Iran) and the richer (Abu Dhabi, Kuwait, Saudi Arabia). However, total capacity of the poorer countries is limited. If they attempted to increase output by say 2–3 mbd, the richer countries could respond in one of two ways. A group of rich countries could reduce output to force the price up. Although this might lead to a drop in revenue, it might be regarded as rational, either for political reasons or more obviously to conserve a scarce resource. Saudi Arabia, on the other hand, with reserves of 173 billion barrels and a capacity of 10.8 mbd was in a position to increase its output from its 1975 level of 7 mbd, to force the price down and punish defectors. In fact from 1974 to late 1979 the price of oil dropped in real terms by about 10 per cent, OPEC output increased to 31.5 mbd, while Saudi Arabian output increased substantially to 9.5 mbd. By 1978, OPEC oil revenue had increased to $170 billion while OPEC imports had increased substantially to force down their trade surplus of $64 billion in 1974 to $5 billion. US oil imports of 5.5 mbd in 1974 increased to 8 mbd by 1978, while world supply was increased due to new developments in Alaska, Mexico and the North Sea.

The events in Iran in 1979 brought its production down from 6 mbd to 3.5 mbd, and the price rose from $13.84 in March, to $23.5 in June. By November, Libya, Nigeria and Algeria were able to increase the price of their light superior grades to $26.27, while by December a price differential was apparent between Saudi Arabia at $24 per barrel and Qatar at $27.42.

In 1980 the OPEC surplus reached $100 billion, and by early 1981 the price of Arabian light crude on the Rotterdam spot market touched $42. Out of fear that these high prices would reduce world demand for oil and affect the viability of the OPEC coalition, Saudi Arabia increased output to 10.5 mbd and was able to enforce a more uniform price structure of $35.5 per barrel.

The 5.5 per cent drop in GNP in Britain between 1980 and 1981 was an extreme illustration of the depth of the recession triggered by high oil prices and the high interest rate strategy adopted by the US to deal with inflation. Total oil demand in the non-communist world dropped from 50 mbd to about 42 mbd for 1982, and the International Energy Agency expects demand to fall a further 7 per cent. By 1981 the OPEC surplus had fallen to $60 billion. In an attempt to preserve the official OPEC price, OPEC output was reduced from its 1980 level of 31 mbd to 25 mbd (October 1981). By March 1982, the Rotterdam spot market price had touched $29 per barrel, and Saudi Arabia had reduced output to 7.5 mbd, while the rest of OPEC produced 10 mbd.

Between 1981 and 1982 Nigeria’s surplus of $2.2 billion had turned into a $2.3 billion deficit, and its output had fallen from 1.3 mbd to
Table 1.1
OPEC oil production

<table>
<thead>
<tr>
<th></th>
<th>OPEC oil exports in mbd</th>
<th>August 1979</th>
<th>January 1983</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1970</td>
<td>1972</td>
<td>1975</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>3.72</td>
<td>5.92</td>
<td>7.00</td>
</tr>
<tr>
<td>(with Kuwait)</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Iran</td>
<td>3.60</td>
<td>4.79</td>
<td>5.30</td>
</tr>
<tr>
<td>Iraq</td>
<td>1.49</td>
<td>1.04</td>
<td>2.20</td>
</tr>
<tr>
<td>Kuwait</td>
<td>2.96</td>
<td>3.21</td>
<td>2.00</td>
</tr>
<tr>
<td>United Arab</td>
<td>1.54</td>
<td>2.03</td>
<td>1.40</td>
</tr>
<tr>
<td>Emirates</td>
<td>—</td>
<td>—</td>
<td>0.44</td>
</tr>
<tr>
<td>Qatar</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Sub total</td>
<td>13.31</td>
<td>16.99</td>
<td>18.34</td>
</tr>
<tr>
<td>Venezuela</td>
<td>3.52</td>
<td>3.10</td>
<td>2.30</td>
</tr>
<tr>
<td>Nigeria</td>
<td>—</td>
<td>1.72</td>
<td>1.80</td>
</tr>
<tr>
<td>Libya</td>
<td>3.25</td>
<td>2.22</td>
<td>1.50</td>
</tr>
<tr>
<td>Indonesia</td>
<td>—</td>
<td>—</td>
<td>1.30</td>
</tr>
<tr>
<td>Algeria</td>
<td>0.98</td>
<td>1.02</td>
<td>0.95</td>
</tr>
<tr>
<td>Gabon</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Ecuador</td>
<td>—</td>
<td>—</td>
<td>0.16</td>
</tr>
<tr>
<td>Sub total</td>
<td>7.75</td>
<td>8.06</td>
<td>8.01</td>
</tr>
<tr>
<td>Total</td>
<td>21.06</td>
<td>25.05</td>
<td>26.35</td>
</tr>
</tbody>
</table>

Source: PIW Petroleum Economics

630,000 bd. As a result of the $4 differential between Nigerian oil and the official OPEC price, Gulf, Texaco and Shell have refused to buy Nigerian oil, although Mobil was pressured by Saudi Arabia into taking 150,000 bd. Apparently the Gulf States offered Nigeria $1 billion in soft loans in an attempt to dissuade Nigeria from dropping its price below the official OPEC price. On the other hand Iran is desperate for revenue to support its war with Iraq, and has contracted to sell 270,000 bd at $25 per barrel.

The final blow to the OPEC price maintenance strategy was the announcement by the British National Oil Corporation in early March 1982 of a 4 per cent drop in price to $31 per barrel, accompanied by an increase to 1.9 mbd oil output from the British North Sea fields
(compared to an average 15.8 mbd OPEC output level by April).

While the high absorber OPEC countries, such as Nigeria, clearly benefit from maximum oil prices, the low absorbers, who have invested heavily in the West, have realised the necessity of balancing their interests. As oil prices are increased, recession bites more deeply, demand in the West drops more than was imagined possible, and new oil sources from the North Sea, Mexico, Alaska, US and Canadian shale fields and so on become available. The Saudi problem is clearly that of adjusting output to that level which optimises its return from investment and oil, and yet is consistent with the maintenance of the OPEC coalition.

The danger is that the oil symbiosis between OPEC and the West is deeply destabilising. Even though the 1981–2 recession and fall in demand has persuaded some commentators that the OPEC coalition is about to fall apart, it seems likely that Saudi Arabia's ability to adjust its output in the range 4–10 mbd can keep the coalition in line. The lower prices expected in late 1983 are likely to lead to increased economic activity in the West, and increased demand for oil. If OPEC then increases prices as it did in 1973 and 1979 then this growth will be cut short, and OPEC will face the same situation as in 1982. To smooth this excessively cyclic process, continuing negotiation between OPEC and the oil consumers is necessary. Until now the West has adopted a fairly aggressive posture towards the OPEC coalition, and the individual developed countries have concentrated for example on selling whatever they can to Saudi Arabia and others to help with their own balance of payments deficits. There is no reason to suppose that this process is at all pareto optimal.

Table 1.2

Indicators in the industrial countries

<table>
<thead>
<tr>
<th></th>
<th>Inflation</th>
<th>Unemployment</th>
<th>Trade ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>12.4</td>
<td>11.0</td>
<td>5.7</td>
</tr>
<tr>
<td>Japan</td>
<td>2.4</td>
<td>5.0</td>
<td>2.0</td>
</tr>
<tr>
<td>West Germany</td>
<td>5.2</td>
<td>6.5</td>
<td>3.2</td>
</tr>
<tr>
<td>France</td>
<td>10.0</td>
<td>13.5</td>
<td>6.0</td>
</tr>
<tr>
<td>Italy</td>
<td>18.8</td>
<td>21.0</td>
<td>3.7</td>
</tr>
<tr>
<td>UK</td>
<td>12.4</td>
<td>11.5</td>
<td>5.9</td>
</tr>
</tbody>
</table>

Source: OECD
The non-oil-producing less developed (NOPLD) countries suffer most from this process. UNCTAD has estimated that total debt of these poor countries increased from $329 billion in 1979 to $384 billion in 1980, to perhaps $440 billion in 1981. Moreover the proportion of NOPLD debt owed to high cost private creditors has increased from 17 per cent in 1970 to 39 per cent in 1978. Although the banking community congratulates itself on the success with which some of the OPEC surplus has been recycled to poor countries, the NOPLD level of debt is now over 20 per cent of their gross national product, and debt service is about 16 per cent of total exports.

Table 1.3

<table>
<thead>
<tr>
<th>Current account balances by region</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial countries</td>
</tr>
<tr>
<td>OPEC</td>
</tr>
<tr>
<td>NOPLD</td>
</tr>
</tbody>
</table>

Source: IMF Annual Reports

As Table 1.3 indicates, after each price hike the OPEC current account, naturally, improves spectacularly while the industrial countries slump into deficit. While these developed countries can adapt and even go into surplus (as they did between 1973 and 1974) the NOPLD sink continuously into deeper deficit.

Payer (1976) raised the point, quite early on, that default on private bank loans by some of the most seriously indebted countries (such as Brazil) could bring about great problems for the western banking system, while Willard Butcher, president of Chase Manhattan argued in Euromoney (October 1980) that there was a need for ‘a partnership of the World’s private banks as well as the political and financial mechanisms of the World’s international institutions’. Recently the Reagan administration has shown signs that it proposes to reduce the degree of IMF and IBRD resource flows to the poor countries.

At the same time the poor countries that export raw materials are faced with falling prices, while those with some manufacturing base (in textiles, shoes and so on) have to contend with increasing protectionism by the developed countries.
The new international economic order

General dissatisfaction on the part of the less developed countries with the General Agreement on Trade and Tariffs led to the setting up of the UN Conference on Trade and Development in the 1960s. Raul Prebisch, previously Executive Secretary of the Economic Commission for Latin America, was appointed Secretary General of UNCTAD. His report, *Towards a New Trade Policy for Development*, was presented at the first UNCTAD meeting in Geneva in March 1964, and proposed:

a) the raising of the prices of primary commodity prices through multilateral commodity agreements;
b) a compensatory financing system, founded by the developed countries to compensate the poorer countries for deteriorating terms of trade;
c) preferential tariff systems by which developed countries give preferential treatment to manufactured goods from the poorer countries;
d) encouraging regional industrialisation schemes in neighbouring less developed countries (LDCs);
e) softening of aid to reduce LDC debt burdens;
f) increased participation of LDCs in shipping, insurance, and so on.

Clearly these issues are still alive today. Preferential tariffs, the Generalised System of Preference (GSP), did come into operation in 1975. The compensatory finance scheme (CFS) has been discussed above. Commodity arrangements will be discussed below.

UNCTAD was set up as a permanent organisation, and the developing countries formed themselves into a Group of 77 through which to negotiate with the developed countries.

While tariffs were reduced overall during the Kennedy Round of GATT trade negotiations (1964–7), G–77 argued that the tariff cuts on goods traded between developed countries were on the whole higher than on the manufactured goods that LDCs hoped to export. In the next two meetings of UNCTAD, in New Delhi in 1968 and Santiago in 1972, the polarisation between the LDCs (the South) and the developed countries (the North) became more pronounced.

During this period a number of commodity coalitions were set up. The copper producers group (CIPEC), including Chile, Peru, Zambia and Zaire, was set up in 1967 (see Mikdashi, 1976 and chapter 7 of this book), the aluminium group (IBA) first met in Belgrade in 1973, and the union of banana exporting countries (UPEB) was formed in 1974.

To some extent there was widespread concern in the early 1970s about the future availability of mineral resources (Meadows et al., 1972;
Mesarovic and Pestel, 1975; Connelly and Perlman, 1975) and perhaps this suspicion of long-term scarcity provided the context in which producer countries saw some benefit from commodity co-operation.

The Economic Declaration of the Summit Meeting of Non Aligned Countries, meeting in Algeria in September, recommended:

The establishment of effective solidarity organizations for the defence of the interests of raw material producing countries such as the Organization of Petroleum Exporting Countries (OPEC) and the InterGovernmental Committee of Copper Exporting Countries (CIPEC), which are capable of undertaking wide ranging activities to recover natural resources and ensure increasingly substantial export earnings . . . .

There has been substantial debate about the likely success of producer coalitions in increasing commodity prices (Bergsten, 1973; 1974, a, b, c; Mikdashi, 1974). In general terms however oil does rather seem to be an exception among commodities. As Krasner (1974) has pointed out, the low absorbing oil producers had substantial financial reserves prior to 1973 and had nothing really to lose from restricting output, if necessary, to increase prices. Moreover coalition theory (Schofield, 1977; Bobrow and Kurdele, 1976) would indicate that some degree of producer concentration within the coalition is necessary for the group to act together. Finally analysis of price elasticity in the short and long term suggests that, in most minerals, prior hikes induce countervailing substitution and further exploration. In the case of some minerals, such as copper and aluminium discussed at length in chapter 7, the existence of powerful multinational corporations, heavily engaged in worldwide production, limits the possible extent of cartel action.

In foodstuffs, price fluctuations tend to be very much dependent on random supply variations, and simple coalition supply restriction is unlikely to be effective. While the structure of every commodity market is different, the most detailed analysis (Rangarajan, 1978) indicates that for one reason or another — lack of concentration in production, political differences between producers, possibilities for substitution, lack of access to necessary technology — producer control is a near impossibility.

Following on from the oil price rises in 1973, Houari Boumediene, President of Algeria and President-in-office of the Non-Aligned Countries, called for a Special Session of the UN General Assembly. At this session in April and May 1974 the LDCs introduced a Declaration and Programme of Action on the Establishment of a New International Economic Order (NIEO).

In dealing with raw materials, the Programme urged that 'all efforts
should be made to facilitate the functioning and to further the aims of producers' associations'. Other issues that were raised included increased food production, enlargement of the generalised system of preference, reform of the international monetary system (including creation of additional liquidity for LDCs), the SDR link, assistance with industrialisation and the transfer of technology, control over multinational corporations, and co-operation among developing countries. Perhaps the most discussed aspect of the new international economic order is the proposal for an Integrated Programme for Commodities (IPC) the first outline of which was set down by the UNCTAD Secretariat in 1974.

As 1975 continued and commodity prices fell there was extensive discussion on the possibility of commodity price stabilisation schemes. On 28 February the EEC and forty-six countries in Africa, the Caribbean and the Pacific signed the Lomé Convention. Chapters 4, 5, and 6 of this book examine in detail the operation of the export earnings stabilisation scheme STABEX associated with this Convention, as well as the form by which the Convention addresses a similar set of issues to those raised in the UN General Assembly.

In May 1975 at the Meeting of the Heads of Government of Commonwealth Countries in Jamaica, the British Prime Minister, Harold Wilson, put forward a proposal for a general agreement on commodities which emphasised expansion and diversification of production and processing and the security of supplies, together with the necessity for maintaining equitable prices. In many ways this scheme is similar to the Second Lomé Convention minerals scheme (MINEX) discussed in chapter 4. Indeed a number of ministers at Jamaica, while rejecting Wilson's proposal, made complimentary remarks about the spirit of Lomé.

At the Seventh Special Session of the UN General Assembly in September 1975, the US Secretary of State, Kissinger, presented another proposal, a Resources Bank, which would increase capital investment in resource production, through World Bank involvement. At the same time the US expressed a willingness to engage in producer-consumer negotiations to set up International Commodity Agreements (ICAs) on a commodity by commodity basis.

The Seventh Session adopted a resolution, Development and International Economic Co-operation, which included the remark that:

An important aim of the fourth session of the UNCTAD . . . should be to reach decisions . . . in the field of raw materials and commodities of export interest to the developing countries . . . with respect to an integrated programme . . ., the decisions should bear on . . . international stocking and other forms of market arrangements for securing stable, remunerative
and equitable prices for commodities.

The Secretary General of UNCTAD was also requested to present a report at UNCTAD IV, the following year, on the integrated programme and indexation schemes. The theme of these reports (UNCTAD, 1976) was the establishment of internationally owned stocks of commodities, serviced by a Common Fund (CF). By buying and selling the commodities, price fluctuations would be reduced. Included in the scheme would be ten 'core' commodities (cocoa, coffee, copper, sugar, cotton, jute, rubber, sisal, tea and tin) and eight others (bananas, bauxite, beef and veal, iron ore, timber, manganese, phosphates and vegetable oils).

After a month of negotiations at UNCTAD IV in Nairobi in May 1976 a resolution on the Integrated Programme was adopted. The stated objective was to improve the terms of trade of developing countries, and to:

achieve stable conditions in commodity trade, including avoidance of excessive price fluctuations, at levels which would:

a) be remunerative and just to producers and equitable to consumers;

b) take account of world inflation . . .

As Behrman (1979) has observed the last phrase seems to imply indexation of commodity prices, although this could not be stated because of its unacceptability to the developed countries. More generally the less developed countries of G—77 and the more developed perceived considerable conflict of interest in the development of this new economic order (Rothstein, 1979). The emphasis on the general principle of the integrated programme by the less developed countries may also have prevented compromise on the wider set of issues that had been initially considered at the Sixth Special Session. The developed countries had deep suspicions that indexation lay at the heart of the programme as well as general doubts about the economic efficiency of the arrangement.

Some of these doubts have been well expressed by Johnson (1977). Under certain conditions if price fluctuations are due to random demand changes then a price stabilisation mechanism will stabilise export earnings; on the other hand if the shocks occur on the supply side then earnings may be destabilised (Johnson, 1976).

The commodities covered by STABEX in the Lomé Convention tend to be perturbed on the supply side, and therefore an earnings stabilisation scheme is more logical. Johnson also asks why it is so readily assumed that international institutions will be more effective than private agents in responding to price signals in the 'correct' way. Finally price
stabilisation addresses the symptoms of the problem, rather than the root cause. Far more effective would be the enhancement of world trade, and the extension of production gains through further freeing of international trade and investment flows (Cooper, 1977; Malmgren, 1977).

As regards the operation of a buffer stock stabilisation scheme, the conventional wisdom is that when the source of price fluctuations is on the demand (respectively supply) side then consumers (respectively producers) gain. For some of the commodities (especially minerals and industrial raw materials) demand considerations would seem to dominate. On the other hand the developing countries are net cereal importers, so price stabilisation would, by this argument, help the exporters — the US and Canada.

A recent paper by Nguyen (1980) indicates that the difficulty over destabilising the earnings from demand elastic, supply variable commodities can be offset by using the buffer stock to stabilise earnings. The analyses of both McNicol (1976) and Behrman (1979) also indicate that, at least for the ten core commodities, the gains to both producers and consumers, resulting from a buffer stock operation, could be considerable, although this depends on assumptions about the buffer stock costs (Laursen, 1978).

An analysis by Sarris, Abbot and Taylor (1979) of the possible operation of a buffer stock in grain is also very interesting. As discussed in chapter 8, net grain exports from North America have increased rapidly (from 39 million metric tons in 1960 to 91 million in 1973), while grain imports increased even during the spectacular grain price increases of 1972—4. The analysis suggests that the price inelasticity of demand by poorer countries gives very large price increases on those occasions when weather or Soviet buying strategies reduces supply. A standard deviation in production of 11 million metric tons (mmt) is associated with a 5.5 mmt standard deviation in trade. A buffer stock with a capacity of 15 mmt, stabilising prices at $140 per metric ton, with a $40 upper and lower band, leads to quite significant savings for importers. Although this benefits the developing countries, both Japan and the USSR gain substantially.

From all these analyses it would appear that there is significant scope for some level of international intervention in commodity markets to stabilise prices, export earnings, and in the case of wheat, to provide a failsafe mechanism to prevent the worse kind of effects of random climatic or political events.
The current situation

At UNCTAD IV it was envisaged that the total resources of the Common Fund in financing the commodity agreements would be of the order of $6 billion, with $2 billion subscribed by member governments and $4 billion obtained through borrowing. By the third Negotiating Conference on the Common Fund in March 1979, it was envisaged that $400 million of government contributions would be allocated to the First Window — for financing buffer stocks — and $70 million to the Second Window — for development of processing, marketing and so on.

A number of separate commodity agreements are also in force or being negotiated at present. The previous cocoa agreement (ICCA) expired in March 1980, but although there was $230 million left in reserves, the Ivory Coast did not agree to a price band of $1.00—$1.50 per pound. Eventually the ICCA came into force in August 1981 without the Ivory Coast or the US. Members of the ICCA account for over 70 per cent of world exports and 60 per cent of imports. The buffer stock manager was expected to be able to buy approximately 90,000 tonnes of cocoa, well above the year’s expected surplus of 70,000 tonnes, and raise the price above the intervention level of $1.04 per lb. However his resources of $220 million proved inadequate and by March 1982 the price had dropped to 76¢ per lb.

The seventy-three members of the International Coffee Organisation (ICO) met in London in April 1981, to allocate export quotas to alleviate the rapid fall in coffee prices as a result of booming production, particularly in Brazil. The quotas totalling 56 million bags (each 60 kg) were decided in September 1981, against the protests of various members: Ethiopia, Indonesia, Papua New Guinea, Kenya and Ecuador. Since the middle of 1981 the export quota system was effective in increasing coffee prices from 80¢ per lb to $1.35 per lb by February 1982. At the same time the ability of the ICO to increase quotas gives it the power to keep prices in the $1.20—$1.40 band, acceptable to the coffee importers. On the other hand there is conflict between Brazil (with 25 per cent of world exports) and Colombia over redefining quotas in Colombia’s favour. A conference involving all seventy of the ICO members was held in June 1982 to attempt a compromise.

The International Sugar Agreement (ISA) involves an export quota system to keep the price in the band 13—33¢ per pound. Under the system 14.3 million tons of export quotas are distributed among 28 exporting countries. However the EEC, which is not an ISA member, exports about 3.5 million tons, even though it also imports over a million tons of sugar under the terms of the Lomé Convention (see Chapter 4). This provokes conflicts with a country such as Austria, which used to export 350,000 tons to Britain but is excluded from
doing so under the EEC trade arrangements. Indeed there is the prospect that the EEC may be accused of contravening GATT regulations by dumping products such as beef and dairy products which come under the Common Agricultural Policy (CAP). Principally because the EEC is not restricted by the ISA quota arrangements, the agreement has not proved effective in keeping sugar above 13¢ per lb (in late 1981 the price was 11.5¢ per lb). The difficulty for the ISA is to renegotiate an agreement which is attractive enough to persuade the EEC to join, and is yet compatible with the interests of the other members.

International Tin Agreements (ITAs) have been in force since 1956, although the US did not join the arrangements until 1976. Annual production is around 185,000 tons, while the US has a substantial stockpile (Desai, 1980) and has on occasion released 30,000 tons in one year. At the International Tin Council Session in April 1981 in London, the US resisted demand for a 10 per cent price rise, while the producers argued the surplus was due to US tin sales. The producers walked out of the meeting. It had been proposed that a buffer stock of 30,000 tons would be used to control prices, and export quotas applied if the stock reached 40,000 tons. While the US argued that a buffer stock of 70,000 tons without quotas should operate, the producers feared that such a stock would be beyond their financial capabilities. The fifth ITA was extended until June 1982 in the hope that negotiations between the US and the producer countries would lead to a resolution of their differences.

In 1979 an international rubber agreement was reached, which will involve a buffer stock of 550,000 tonnes and a price band of 1.5 to 2.7 Malaysian dollars per kilo. The consuming members of the International Natural Rubber Organisation (INRO) have refused requests for an increase in the minimum buying intervention price set under the agreement. Indeed support purchases of 100,000 tonnes by the INRO buffer stock manager had little effect on the price. However three countries (Malaysia, Indonesia and Thailand) control nearly 80 per cent of world production, and there was evidence in early 1982 that these producers are engaged in market support operations for rubber and possibly tin.

In all agreements there are severe conflicts of interest between the exporting less developed countries and the importing more developed countries. When the developed countries are exporters the conflicts are even more pronounced. Because of the requirements of the Common Agricultural Policy or the Lomé Convention, the EEC is forced to act against the interests of Third World raw material exporters.

The US remains a member of the International Tin, Sugar and Rubber Agreements since it benefits by agreements to release stocks when prices rise. However the US has objected to suggestions for a new
International Wheat agreement on internationally controlled wheat stocks (in line with the proposals of Sarris et al. mentioned above), possibly because as the biggest exporter (controlling 50 per cent of world trade) it fears the burden of the cost of such stocks. It is possible however that an equitable formula could be found for the distribution of the costs of international security stocks.

The idea of the integrated programme was clearly to provide a forum for negotiation across a large set of commodities, so that trade-offs across commodities would make it easier to come to solutions on particular commodities. However decision-making in the policy-making council of the IPC is by weighted voting, with voting quotas allocated by common fund contributions. The five large industrial countries — US, UK, West Germany, France and Japan — have 27 per cent of the voting quotas. Since a 75 per cent majority is required this gives the industrial countries an effective veto. The ratification process for the $400 million Common Fund is also proceeding very slowly, because countries like Brazil, which are deeply involved in one of the individual commodity agreements, see little return for their contribution.

In other areas of North-South relations the signs that co-operative agreements can be attained are not auspicious. Even within the Tokyo Round of Multilateral Trade Negotiations (MTN), discussed more fully in a later chapter, little was done to change the degree of non-tariff protection. Indeed loopholes in the agreements, such as orderly marketing arrangements are being made use of more frequently, as the EEC and the US defend themselves against the increasingly competitive exports of developing countries (Strange, 1979; 1981). The Textile Multifibre Agreement (MFA) signed in 1973 allowed for a controlled 6 per cent of exports from developing countries. Even with this agreement textile employment in Europe declined by 700,000 between 1974 and 1977. The MFA was renegotiated in 1977, and the 'reasonable departures' clause allowed the EEC to sign bilateral agreements which set import quotas for exporters — South Korea, Hong Kong, Brazil and India. The Third World countries are critical of the erosion of the MFA through these safeguard clauses, and have pointed out that while their exports have declined, exports from the US to Europe have increased (from 150 million tons in 1976 to 211 million tons in 1979). On the other hand if the MFA is allowed to expire at the end of 1981 then developing countries will be forced to negotiate one by one with the EEC, and this is likely to lead to further import restriction. Cooperation between developed countries is also proving increasingly difficult.

Japan's high level of trade protection has forced both the EEC and the US to seriously consider retaliatory moves. From the point of view of the US, Japan's trade surplus of $34 billion ($25 billion with the US)
is unforgivable. At the same time the US and the EEC are at loggerheads over steel dumping and farm subsidies. While every developed country appreciates the importance of world trade (at $2,000 billion and 20 per cent of GNP) individual developed countries are making vigorous attempts to deal with inflation by cutting domestic demand and thus imports, while attempting to keep up exports. Clearly not all countries can adopt this strategy.

The Brandt Report’s main proposal was to stimulate international trade through an international trade organisation by supporting a massive increase of exports from North to South, which in turn would trigger new demand for the more traditional raw material exports of the South.

A relaxation of the developed countries’ unemployment problems would also permit expansion of Third World exports in shoes, textiles and then steel, ships, and so on. Of course such a strategy would require a large increase in the financial base of the IBRD and IMF, along the lines that Keynes originally had in mind. The enormous level of unemployment in the developed countries (30 million in 1982 of which 9 million is in the EEC) and the significant GNP gap does imply that the inflationary consequences of such a strategy would not be excessive.

However, the inflation paranoia of the UK and the US has forced them to adopt monetarist interest rate policies which operate to kill demand and economic growth not only domestically, but in both developed and less developed countries. The US GNP fell at an annual rate of 4.5 per cent in the last quarter of 1981, and at a rate of 3.9 per cent in the first quarter of 1982. This can only exacerbate the trade problems of Europe and the Third World.

As for North-South co-operation, an integral part of any move towards a new international Keynesian order, the North-South Summit in Cancun in October 1981 made it clear that nothing significant can be expected in this direction. While these policies in the US and Britain are maintained, international trade will decline and the Northern countries will be faced with increasing economic and social disorder in the South. As the Southern export markets decline, and raw material supplies become endangered, it is probable that competition between the developed countries will increase, with all the ensuing dismal consequences of trade and money wars.

In September 1982, the fears expressed by Payer, about the stability of the international monetary relationship between North and South, were seen to be very real. High interest rates and a bunching of loans forced a number of Latin American countries, including Mexico, Argentina, Chile, Cuba and Bolivia to seek some form of rescheduling of loan repayments.
Mexico's position was perhaps most dramatic. With $85 billion international debt, of which $50 billion was owed by the public sector, it found itself due to pay $11 billion on the public sector debt and $7.5 billion on the private debt in the last four months of 1982. On 31 August 1982 Mexico had agreed to a $1.85 billion rescue package negotiated with the Bank for International Settlements in Basle, and was still negotiating a 90-day moratorium on repayment of $10 billion. The next day, President José Lopez Portillo in his parting speech as president, announced the nationalisation of Mexico’s banks. This announcement, with Mexico’s outstanding arrears of $400 million on interest, and rumours that Mexico would renego on about $15 billion capital repayments in late 1982, intensified fears that Mexico and other Latin American countries might default on their international loans.

Argentina's position, with $38 billion in international debts and arrears of $3 billion is not dissimilar to that of Mexico but is made even more difficult because of the freezing in British banks of $600 million of Argentinian assets, carried out in retaliation for the freezing of British assets during the Falklands war.

Meanwhile Cuba began negotiations to reschedule $1.3 billion of loans due for repayment before 1985, while Costa Rica attempted to renegotiate debts of $4 billion while arranging an IMF loan of $140 million.

At the IMF/World Bank Meeting in Toronto, the IMF interim committee agreed during the weekend of 4–5 September to increase the IMF quotas, and thus effectively increase the capability of the IMF to assist Third World countries with rescheduling.

IMF quotas of $60 billion special drawing rights are currently about 4 per cent of total world trade, a much lower proportion than in the past. Most of the members of the interim committee were in favour of a doubling of quotas. However Germany and the UK wanted an increase of only 50 per cent, while the US insisted on restricting the increase to 20 per cent.

Instead Dr Beryl Sprinkel, US Treasury Under Secretary, proposed the setting up of a ‘super fund’ along the lines of the General Agreement to Borrow, which would be designed specifically for less developed countries such as Mexico, Brazil and so on with significant debt problems.

As Dennis Healey, Labour Shadow Foreign Secretary, had argued just before the IMF meeting even doubling IMF quotas to $120 billion could only be on a short-term response, given the extent of the world economic problem, and in particular the collapse of commodity prices and intensity of the Third World indebtedness.

The fundamental question underlying the debate is whether the IMF, World Bank and GATT are effective enough agencies to deal with the
rapidly developing crisis. As Robert Muldoon, Prime Minister of New Zealand, suggested at the meeting of Commonwealth ministers at the beginning of September, it might well be an appropriate time to consider setting up an international trade and monetary organisation, as was originally envisaged at Bretton Woods in 1944.

As regards trade, serious disagreements developed between the EEC and the US as a result of implementation of US sanctions against European firms supplying equipment for the Soviet gas pipeline, and of legal action by US steel producers against European companies exporting to the US. The attempt by the EEC to impose further restrictions on textile imports from the Third World did nothing to allay fears that increasing protectionism on the part of developed countries would further exacerbate the problems faced by the less developed countries.

On the whole the developed countries tend to prefer to work with the institutions, and their constraints, which are currently available. In a sense these institutions legitimate minor tinkering with what is regarded as an essentially free trade world economy. The implications however which might well be drawn not only from recent events in the real world, but also from developments in general equilibrium theory, is that national economics will attempt to 'manipulate' the world economy to their own advantage.

While the steel, textile and interest rate 'wars' are the visible attempts at manipulation, the consequences are the monetary instabilities that are making themselves felt. An alternative to the liberal economic order, and the manipulations which are now such an inherent part of this order, is a 'managed' new international economic order.

Perhaps it is wishful thinking to believe that, as the economic crisis deepens, more political leaders will be seriously concerned to open up the dialogue on the means of managing and the rules of behaviour of a new international economic order.

References


Bergsten, C.F. (1973), 'The Threat from the Third World', Foreign Policy, 11.

Bergsten, C.F. (1974a), 'The Threat is Real', Foreign Policy, 14.


the Next Decade’, in J.N. Bhagwati (ed.).
_The Limits to Growth_, London: Pan.
Mesarovic, M. and Pestel, E. (1975), _Mankind at the Turning Point_,
London: Hutchinson.
Mikdashi, Z. (1976), _The International Politics of Natural Resources_,
Ithaca: Cornell University Press.
Export Earnings Instability and Level: Implications for the North
South Negotiations’, in A. Sen Gupta (ed.).
Cox and H. Jacobson (eds).
Payer, C. (1976), ‘Third World Debt Problems: The New Wave of Def-
Rangarajan, L.N. (1978), _Commodity Conflict: The Political Economy
of International Commodity Negotiations_, Ithaca: Cornell University
Press.
Rothstein, R.L. (1979), _Global Bargaining: UNCTAD and the Quest
Sarris, A.H., Abbot, P.C. and Taylor, L. (1979), ‘Grain Reserves, Emer-
gency Relief, and Food Aid’, in W.R. Cline (ed.).
Choice_, 30.
North South Negotiations_, London: Frances Pinter.
Solomon, R. (1977), _The International Monetary System 1945–1976:
Strange, S. (1976), _International Economic Relations of the Western
World 1959–1971_, London: OUP for the Royal Institute of Interna-
tional Affairs.
Strange, S. (1979), ‘The Management of Surplus Capacity: or how does
theory stand up to protectionism?’, _International Organisation_, 33.
Strange, S. (1981, ed.), _The International Politics of Surplus Capacity,
Triffin, R. (1960), _Gold and the Dollar Crisis_, New Haven: Yale University
Press.
UN (1976), _Integrated Programme for Commodities_, TD/RES/93(IV).
UNCTAD (1974), _An Integrated Programme for Commodities_,
ID/B/C/1/166.
UNCTAD (1976), _New Directions and New Structures for Trade and
Development, Report by the Secretary General of UNCTAD to the
Conference: TD/183_.

(Added in press, May 1983)

At the time of going to press, the situation is even more ominous. The stabilising of oil prices had helped Mexico, but attention has now focused on Brazil, which is now $90 billion in debt. As Table 1.4 indicates, debt service on loans to the seven Latin American countries in greatest difficulties is of the same order of magnitude as their export earnings. Debt repayment for Brazil will be $7.2 billion in 1983 increasing to $16 billion in 1987. Even if Brazil manages a $6 billion trade surplus for 1983, the prospects are calamitous. IMF-induced devaluation and deflation are unlikely to increase the Brazilian trade surplus in the present world economic climate.

Table 1.4
Latin American Debt

<table>
<thead>
<tr>
<th>Country</th>
<th>Debt (billions $)</th>
<th>Debt service (billion $)</th>
<th>Debt service Ratio to earnings (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>90</td>
<td>32</td>
<td>120</td>
</tr>
<tr>
<td>Mexico</td>
<td>85</td>
<td>35</td>
<td>125</td>
</tr>
<tr>
<td>Argentina</td>
<td>38</td>
<td>15</td>
<td>150</td>
</tr>
<tr>
<td>Venezuela</td>
<td>32</td>
<td>17</td>
<td>100</td>
</tr>
<tr>
<td>Chile</td>
<td>22</td>
<td>7</td>
<td>100</td>
</tr>
<tr>
<td>Peru</td>
<td>10</td>
<td>6</td>
<td>80</td>
</tr>
<tr>
<td>Colombia</td>
<td>8</td>
<td>5</td>
<td>100</td>
</tr>
<tr>
<td>Other countries</td>
<td>15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>300</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source*: Morgan Guaranty and the Bank for International Settlements