THE MANAGEMENT OF THE WORLD ECONOMY

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So distribution should undo excess,
And each man have enough

(*King Lear*, IV. i. 73–7)

First published 1983 by
THE MACMILLAN PRESS LTD
London and Basingstoke
Companies and representatives
throughout the world

ISBN 0 333 34236 4 (hardcover)
ISBN 0 333 34237 2 (paperback)

Printed in Hong Kong

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Preface

This book has two basic aims: to provide a simple and non-technical introduction to the problems of the modern international economy; and to consider how some of these problems might be overcome, or at least lessened, by more effective management of that economy than exists today. It is not an economic textbook. It is designed as much for the educated layman as for the student; and it is concerned as much with international politics as it is with international economies.

Political and economic issues are anyway not easy to disentangle. It is sometimes said that in domestic societies today most of the problems of politics are economic in origin. This is as true in the international as in the domestic field: many of the most fundamental political issues between states today are the economic conflicts that divide them.

The book is thus concerned with the politics of international economics: what is nowadays sometimes, somewhat inaccurately, termed political economy (that term was originally applied to what is simply now called economics). It therefore examines the problems that arise among states concerning trade, concerning the international monetary system, concerning development aid, energy and energy prices, resources, food and employment questions. It considers the principal causes of dispute among states about such matters. It describes the international institutions which already exist for examining these problems and how far they have proved adequate in confronting them. Finally, the book considers the changes in institutions and policies which would be required to create a more stable economic system as well as a more just world economic order than the one we have today.

E. L.

Acknowledgements

The author wishes to express his grateful thanks to his friends Professor Amartya Sen and Professor David Henderson for their valuable comments on parts or all of the text.

List of Abbreviations

AIOC	Anglo-Iranian Oil Company
BIS	Bank of International Settlement
BP	British Petroleum
Ecosoc	(UN) Economic and Social Council
EEC	European Economic Community
EFTA	European Free Trade Area
FAO	Food and Agriculture Organisation (s.a.)
GATT	General Agreement on Tariffs and Trade
GNP	Gross national product
GSP	Generalised System of Preferences
IBRD	International Bank for Reconstruction of Development (World Bank) (s.a.)
IDA	International Development Association (affiliate of the World Bank)
IEA	International Energy Agency
IFAD	International Fund for Agricultural Development (s.a.)
ILO	International Labour Organisation (s.a.)
IMF	International Monetary Fund (s.a.)
IPC	Iraq Petroleum Company
NIC	Newly industrialising country
OAPEC	Organisation of Arab Petroleum Exporting States
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of Petroleum Exporting Countries
RIIA	Royal Institute of International Affairs
SDR	Special drawing right
Socal	Standard Oil of California
Socony	Standard Oil Company of New York
Texaco	Texas Oil Company
Uncitral	UN Commission on International Trade Law
UNCTAD	UN Conference on Trade and Development

Introduction

THE COLLAPSE OF THE POST-WAR SYSTEM

At the end of the Second World War, a new world economic system was established. It was intended to be very different from any which had existed earlier. It was to be above all an advance on the system that had prevailed between the wars, constricted and contorted as that had been by governmental import controls, exchange regulations, export subsidies, managed exchange rates and nationalist interventions of many kinds.

There were four guiding principles underlying the new arrangements.

First, and most crucial, was the principle of *liberalisation*. Tariffs, quota restrictions, exchange controls, multiple exchange rates, and all the other interferences with a free market so widely practised before were now to be progressively eliminated. After a somewhat hesitant beginning, some progress was made towards achieving that aim. Successive negotiations reduced tariffs among the developed countries to a fraction of their pre-war level: to 5 per cent or so on average against over 20 per cent in the late forties. By the seventies attempts were being made to restrain other types of trade restriction that increasingly replaced tariffs for excluding imports. A similar process took place in the monetary sphere: by the end of the fifties convertibility of non-resident currencies was introduced in most industrialised countries, and a decade or so later currencies were allowed to float freely in the market.

Yet this process of liberalisation was always highly selective. Whole areas of trade were omitted from the beginning. Trade in agriculture was scarcely touched. Other types of trade were little affected: for example, trade in processed products and in simple manufactures. Each of the areas omitted was vital to some countries, mainly in the developing world. In other words, the industrialised states, while willing to seek the benefits of increased specialisation and comparative costs in trade with each other, were not generally prepared to extend the same principles to their trade with poor countries. Those countries themselves, with heavy import requirements and large balance of payments deficits, mostly showed equally little ardour for liberalisation, even for trade with each other. So liberalisation from the beginning, though widely extolled in principle, was not always so enthusiastically implemented in practice.

Secondly, the new system was to be based on the principle of *non-discrimination.* In place of the special favours which under the previous system were often accorded to traditional partners or political associates – in the form of preferences, bilateral trading agreements, barter arrangements or special tariff regimes – economic relations would now be based on the strict application of the most-favoured-nation principle (under which privileges accorded to one nation were to be extended impartially to others applying the same principle). The principle of non-discrimination was widely accepted in theory; and was explicitly endorsed in the rules laid down for the new trading and monetary system. But, again, it was less universally adopted in practice. Colonial preferences were long maintained by Britain, France and other countries; and were continued in a new form in the special treatment given to 'associates' by the EEC. The United States kept preferential arrangements with the Philippines, Hawaii and Puerto Rico. Political discrimination was widespread: communist countries were excluded from the benefits of most-favoured-nation treatment by the United States for political reasons, while special trading arrangements were equally made between the Soviet Union and her allies. So here too practice did not always match principles. But, in theory at least, non-discrimination now became, in the West at least, the norm to which lip-service was paid.

The third principle of the new system was *multilateralism.* The new arrangements were not to be private pacts among small groups, such as had been made between the wars. They would be set up on a basis agreed among the principal nations of the world and would be subsequently supervised and regulated, where necessary, by international institutions set up for the purpose. In other words, some degree of economic sovereignty was to be lost by each participant. Multilateral systems for supervising and regulating trade and monetary affairs were indeed successfully established: in GATT and the IMF respectively. In each case member states were obliged to make undertakings removing a part of their former independence: for example, in raising tariffs and in changing exchange rates. Here too the practice did not always exactly match the principle. When crisis arose, individual countries would halt particular imports, would devalue their currencies, with barely a pretence of consultation. Even so, far more than at any earlier time in human history, a system for the international management of the economic system did seem now to have been created.

Finally, the system was designed to promote *full employment* among the populations of those countries that took part; and therefore required a rapid rate of economic growth. Full employment was an explicit aim (laid down for example in the UN Charter). And it was a condition for participation in the system by some countries: Britain, for example, from the beginning reserved the right to opt out of the new arrangements, in both the commercial and the monetary spheres, if full employment appeared threatened. Here, above all, success seemed to have been secured. For more than two decades, rapid and sustained economic growth was successfully achieved in industrialised countries. It brought with it very low rates of unemployment, which appeared to justify and sustain the new system. During the fifties and sixties, the economies of the rich countries of the world grew faster than at any earlier time in their history: by 4–5 per cent a year. This in turn helped to stimulate rapid development among poor countries too; which on average, indeed, grew faster still. World employment expanded rapidly. A new era seemed to have dawned, more prosperous than any before.

These were the four guiding principles of the new system. From about 1970 onwards, however, each of them became more difficult to fulfil. The most important single change was that high growth was replaced by low growth. Especially from the time of the oil-price rise in 1973, the steady expansion of the world economy ceased. Inflationary pressures, partly stimulated by the oil-price rise, caused governments deliberately to introduce deflation to counter them. This brought, in place of low unemployment, the highest experienced at any time since the 1930s (occasionally still higher). This in turn caused serious problems for poor countries which found that their chief markets declined, the prices of their exports fell, while the price of their imports, from rich countries as well as from oil-producers, rose faster than ever. The failure to fulfil this objective, the maintenance of high employment, in turn threatened each of the others.

The whole process of liberalisation was checked. During the seventies, with declining growth in income and trade, increasing unemployment and increasing competition from elsewhere, there were everywhere calls to save jobs by reducing imports (in other words, by destroying jobs elsewhere). While the old forms of protection – such as tariffs and strict exchange controls – were not usually restored, new types of restriction – non-tariff barriers, anti-dumping regulations, 'voluntary restrictions', 'trigger prices', 'safeguards', and similar methods – were now invented to take their place. So the whole goal of liberalisation, on which the post-war system had above all been based, was increasingly under threat.

The principle of non-discrimination too began to be eroded. Regional grants, industrial subventions, export subsidies and other discriminatory measures to assist home industries were introduced, in the universal effort to save jobs. Discrimination began to take place between whole groups of nations. Regional arrangements were made, discriminating in favour of those within the region: as within the EEC in Europe and within other groups elsewhere. There was discrimination between rich countries and poor. Occasionally this was discrimination in *favour* of the poor: as in the Generalised System of Preferences for some exports of poor countries. More often it was against: as in the arrangements made for restricting textile imports to rich countries, which were applied only to poor countries, even though imports of textiles from other rich countries grew faster.

Finally, the principle of multilateralism was now increasingly challenged. From the beginning the new multilateral institutions had been established on a somewhat one-sided basis. Communist states, by their own choice, played little or no part in them from the start. Most poor countries were not independent at the time when the new bodies came into being and so had no share in shaping them. In practice, therefore, the new 'multilateral' institutions were from the beginning dominated by a restricted group of Western developed states, applying principles which they themselves had chosen. Even after poor states had become the great majority of their members, the structure and voting mechanisms established ensured that they were still dominated by rich ones. In the early years the United States alone enjoyed over 30 per cent of the votes in the IMF and the World Bank; the developed countries as a whole had nearly 80 per cent (as well as most of the seats in the governing council of each body). Even thirty years later, when each had a large majority of poor members, that domination was only marginally reduced (p. 107 below). But it now began to be contested. A 'new international economic order' was increasingly demanded. Developing countries now claimed the right to a share in power in world institutions proportionate to their numbers. Rich countries in reaction made new arrangements for meeting together to reach decisions on their own. Though the *principle* of multilateralism was still widely endorsed, it was a new kind of multilateralism that increasingly emerged.

The entire post-war economic system was therefore under threat. Conditions had become quite different from those at the end of the Second World War, when the post-war system had been established. US power, economic and political, was now dramatically less. The dollar, on which the world's monetary system had been primarily based, was unstable, no longer linked to gold and for long declined in value. The trade of industrialised countries was now threatened, for the first time since 1945, by the rapidly increasing exports of newly industrialising countries (NICs), which, with much lower labour costs and often higher efficiency, could produce similar products for a fraction of the price. Energy, which had been abundant at prices which did not properly reflect its scarcity, under the control of Western companies, now suddenly became exorbitantly expensive, and under the control of producer governments. In many industries – steel, shipbuilding, electronics, textiles and petrochemicals – huge overcapacity emerged. Unemployment rose inexorably, in rich countries and poor alike. And inflation, formerly relatively modest, was now rampant everywhere.

The comfortable assumptions which more than two decades of prosperity had fostered were thus no longer tenable. The two objectives which the post-war system had been mainly designed to secure – liberalisation and full employment – now seemed increasingly difficult to reconcile. In the new conditions the question arose: should the main emphasis of policy be placed on reducing unemployment, even if this involved the abandonment of liberalisation and the persistence of inflation; or should the control of inflation have the greatest priority in economic policy, even if this meant slowing the rate of economic growth and leaving larger and larger sections of the population without work? This question was bitterly disputed, between nations as within them.

It was evident that the economic system of the immediate post-war years was now coming to an end. The question was: what kind of system would replace it?

THE NEED FOR MANAGEMENT

One possible answer to these problems in the world economy was to try to bring it under a more effective international management.

It seemed an obvious conclusion that, since so many of the problems from which individual national economies now suffered had international rather than national causes – world inflation, world energy prices, world recession, world monetary problems – international answers were required. The same type of economic regulation as had been practised for decades, with considerable success, within states should now be used to overcome the instabilities of the international economic system. All the main needs which had brought about regulation by national governments now brought a similar need for management at the international level.

The world trading system, for example, clearly required better international regulation. National governments had for many years intervened to influence trade, internal and external; to protect the interests of producers and consumers alike; to restrain monopolies and other barriers to free trade; and to provide the basis for fair competition. But these aims were now more urgent internationally than nationally. Not only had international trade become a far higher proportion of all trade for every nation; it was internationally that the main barriers to trade, the main distortions and the main inequalities now existed. It was no longer internal tolls, market sharing, monopoly practices and pricing policies within states which required controlling. It was the tariffs and quotas imposed by governments against each other; combinations among national producers of particular commodities; monopolies and special pricing arrangements among private corporations that operated internationally; instabilities in world, not national prices: it was now these that required regulating action.

In the monetary field, again, better international arrangements were required. Here too national governments had over many years controlled the level of credit in domestic markets: by influencing the supply of money, by restraints on lending and by influencing prevailing interest rates. This was required to check inflationary tendencies within each economy, to stimulate demand at times of depression, and to regulate the level of activity generally. But here too it was now at the international level that such action was mainly needed. No state was any longer an island: in establishing its interest rates, budget deficit or money supply, national authorities created immediate effects on other economies too. The rate of interest in the United States, or the level of credit restriction there, affected the world economy as a whole. Inflation had become an international as much as a local phenomenon, exported from one state to another. Recession too was international: still more obviously it was transmitted from state to state and could only be overcome by international action. At the very least, multilateral guidance was needed to co-ordinate national responses: for example, to influence interest-rate policy or trade policy, or to encourage reflation or deflation (so that all were not engaged in deflating or reflating at the same time, with calamitous results). Many felt that more was required than this: that the credit policies of international bodies, such as the

IMF, needed to be adjusted in the common interest, to raise demand in time of recession and to dampen it in boom. Increasingly, to reduce the instabilities of the modern world economy, international counter-cyclical strategies were seen to be necessary.

International action was also required to maintain and conserve threatened world resources. For years national governments had been concerned about the husbanding and development of their national resources, the conservation of their land, and the assurance of energy supplies for their people. But this task too had now become an international responsibility. The rapid depletion of the earth's remaining resources was a disaster that would be felt by all nations: and the conservation of those that remained was therefore a task for the entire international community. Conversely, there was an international interest in ensuring that those resources that existed were accessible and became available at prices that conformed with the economic realities of the day and not with the restrictive practices of a few producers. Again, therefore, the management of the world's remaining resources had become a task which could only be undertaken on an international basis.

The internationalisation of the economy had transformed another task previously performed by individual states. National governments had intervened to promote regional policies: to ensure that the economic development of particular regions did not fall too far behind that of the more prosperous localities within the same state. But to the regional problems of the modern world national action was irrelevant. For inequalities now lay between nations rather than within them. With the growing speed of travel and of knowledge, these inequalities became increasingly conspicuous, and so increasingly unacceptable. Policies designed to spread wealth and investment, therefore, now needed to be undertaken at the international rather than the national level: the transfer of resources to those countries most needing, yet least able, to attract them, in a common effort to promote the development of a common world.

Finally, it was not only geographical inequalities that needed tackling at a wider level. The same was true of inequalities between individuals. Traditionally, national governments had intervened not only to reduce inequalities between regions but also to secure economic justice among their peoples generally; they had done this through progressive taxation and through the creation of social services, paid for primarily by the rich yet benefiting primarily the poor. But in the modern world it was only through international measures that such inequalities could be remedied. Embryonic international social services already existed; in the work of the UN agencies operating in the areas of health, education, labour affairs, children's welfare, food, communications and other fields. But the budgets of these organisations were so small, and their activities consequently so restricted, that they exercised virtually no visible impact on the inequalities that existed in each area. Only the establishment of programmes on a scale far exceeding those set up so far could have any significant effect. And, whatever the scale, the responsibility for organising and administering these services could only be an international one. Here again, therefore, functions that were previously those of national governments could now only be effectively undertaken, given the nature of the inequalities of the modern world, on an international basis.

So in many fields better international arrangements were required. But, even if it were accepted that some more effective management of the world economy was needed, there was a wider question to be considered. What were the purposes which such management should seek to procure? And in whose interests should it be undertaken?

WHAT TYPE OF ECONOMIC MANAGEMENT?

The type of economic policy chosen by those responsible for managing the international economy will depend on the analysis they make of the way that the economy operates at present and the causes of its underlying problems.

There are two main views today about the character of the international economy and the kind of international measures necessary. They differ (like corresponding theories concerning domestic economies) in their assessment of the major problem to be dealt with, and therefore in their choice of the policies to be adopted.

The first might be defined as a broadly monetarist approach (although the precise importance attached to money supply as such would vary considerably). This is the view that has prevailed on international problems among most governments in recent times; certainly, among most rich countries and within international institutions. Under this view the main problem to be tackled, internationally as domestically, is inflation. The main cause of inflation is excess demand, both within individual economies, and, as a result, within the world economy. The principal cause of excess demand is the excessive volume of money and credit generally within the system: again, both in the domestic system (the money supply created or allowed by governments, through government borrowing and lax credit policies) and in the international system (money created by large Euro-currency lending and easy IMF credit policies). The proper remedy for the inflationary pressures in the domestic economy is tighter credit, higher interest rates, balanced budgets and cuts in government borrowing (and therefore cuts in government spending generally). Even national measures of this kind, if applied generally, should reduce inflation elsewhere. Internationally, corresponding measures are needed for the same purpose; tight credit policies (for example, by restricting the volume of funds borrowers can acquire from the IMF), strict repayment terms, and severe conditions for loans (whether from bilateral donors or the IMF), including demands for deflationary policies as the price of credit, restraint in the issue of special drawing rights (SDRs), and restrictions on lending in the Euro-currency market. Development assistance would be limited and conditional, and used for non-inflationary purposes only (for example, for developing new sources of raw materials, and for project rather than programme lending). Trade should be liberalised to maximise the benefits of a market economy and to reduce domestic costs.

The second approach can be styled as broadly Keynesian. Under this approach (reflected, for example, recently in the recommendations of the Brandt Report) the central problem to be confronted is unemployment: in other words, not excessive but inadequate demand. Domestically, this creates a need for more ample credit, for lower interest rates, for higher public spending, for budget deficits: designed to raise demand to meet productive capacity and so create jobs. Internationally, similar remedies are required. More ample credit should be provided: the IMF should thus be willing to provide larger loans, for longer periods, on less rigorous terms; and it should issue SDRs specifically to poor countries to help them import more for development purposes. Bilateral donors and international institutions should be willing to provide greater transfers, in loans and grants, to raise purchasing power among poor countries. And greater assistance should be given in rescheduling or cancelling debts. Rich countries should allow increased access to their markets for the exports of developing countries, without necessarily demanding corresponding concessions in return. The increase in demand so created within the poor countries would enable them to increase their purchases in rich countries; and so help to boost the economies of the latter too. So, world economic activity would be revived; and unemployment, the main problem, gradually reduced.

Each of these analyses corresponds to a widely held view about the