ECONOMIC POLICIES AT CROSS-PURPOSES

THE UNITED STATES AND DEVELOPING COUNTRIES

ANNE O. KRUEGER

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Foreword

IN THE EARLY POSTWAR YEARS, U.S. economic policy toward developing countries consisted almost entirely of foreign aid. Over time developing countries have become increasingly differentiated. As that has happened, U.S. policies regarding international trade, capital flows, debt forgiveness, and the multilateral institutions have assumed growing importance. Unfortunately each set of policies has operated largely independently of the others. Indeed, in some instances, they have offset one another.

In this book, Anne Krueger analyzes the development of these American policies, showing how they have evolved at cross-purposes. She then illustrates her analysis by considering U.S. international economic policies for the Caribbean Basin Initiative and Korea. In each instance, domestic concerns—mostly over sugar and textiles in the case of the Caribbean, and over import competition and the trade balance in the case of Korea—have offset measures designed to support those countries' economic growth. Finally, the author uses these examples to illustrate the urgent need for greater consistency and coordination of American international economic policies.

Anne O. Krueger is Arts and Sciences Professor of Economics at Duke University and a nonresident senior fellow in the Economic Studies program at Brookings. Much of the research for this study was undertaken while she was at Brookings on leave from Duke. She is grateful to Henry J. Aaron and Charles L. Schultze of Brookings for their support of the project.

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BRUCE K. MAC LAURY
President

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Economic Policies at Cross-Purposes

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1 Introduction

WHEN THE REGIME OF Ferdinand Marcos was overthrown in the Philippines in 1986, the United States supported the newly elected government of Corazon Aquino. To that end, the U.S. Congress authorized $210 million of economic assistance to the Philippines in fiscal year 1987. At the same time, however, U.S. quotas on imported Philippine sugar were being reduced, causing the Philippines to lose $89 million, equal to 42 percent of the U.S. aid allocated.[1] In addition, Philippine exports of textiles and apparel to the United States were restricted under the Multifiber Arrangement even as the United States was urging the Philippines to remove protectionist trade barriers to stimulate export growth.[2]

This vignette is typical of U.S. international economic policy vis-à-vis a number of developing countries: the United States extends foreign aid and official lending to enhance economic performance but offsets many, if not all, of the aid's potential benefits with other policies.

While there are obvious reasons for this state of affairs, U.S. international economic policy toward developing countries is undoubtedly in disarray. For many developing countries, the bewildering conflict among U.S. policy instruments leads to antagonism, or at least suspicion. A more coherent set of U.S. international economic policies toward the developing countries could greatly increase the benefits of trade, aid, and other policies without any increase in government expenditures.

The need to reassess U.S. policy is heightened by the fact that developing countries are becoming increasingly important in the international economy. In some cases, such as in East Asia, this newfound importance is a result of rapid economic growth; in others, it derives from both economic and political considerations, as in Latin America and the Middle East.

Table 1-1. **The Role of Developing Countries in U.S. Trade, 1989**

	U.S. exports to developing countries		U.S. imports from developing countries	
Commodity group	Billions of dollars	Percent of all U.S. exports	Billions of dollars	Percent of all U.S. imports
Food	15.69	36.7	14.06	49.7
Raw materials	5.48	33.1	2.51	23.3
Ores and other minerals	1.96	28.0	1.84	32.9
Fuels	3.36	33.7	40.97	73.0
Nonferrous metals	1.29	25.6	2.34	21.2
Total primary products[a]	27.77	34.1	61.71	55.2
Iron and steel	1.58	42.8	2.31	20.2
Chemicals	13.56	35.7	3.25	14.9
Other semimanufactures	6.17	34.5	11.53	31.8
Machinery and transport equipment	51.88	31.2	49.80	23.6
Power generating machinery	2.71	27.3	.83	12.9
Other nonelectrical machinery	12.09	37.0	4.39	13.6
Office and telecommunication equipment	15.98	33.7	27.91	44.2
Electrical machinery and apparatus	6.08	41.3	8.09	44.6
Automotive products	5.76	18.6	6.66	8.46
Other transport equipment	9.26	30.3	1.92	16.1
Textiles	1.61	36.8	2.67	41.5
Clothing	1.46	66.1	19.91	76.5
Other consumer goods	7.80	23.8	23.37	43.2
Total manufactures[a]	84.06	31.7	112.84	30.7
Total trade[a]	117.47	32.3	178.09	36.1

Source: GATT, *International Trade, 89–90*, vol. 2 (GATT, 1990), table A6; percentages calculated by author.
a. Totals include some items not included in any commodity category.

Table 1-1 gives data on the role of developing countries in U.S. exports and imports in 1989, a fairly representative year. Overall, developing countries import about one-third of U.S. exports and are the source of about the same proportion of U.S. imports. However, they are considerably more important for individual commodities: 73 percent of U.S. fuel imports—predominantly petroleum—originate in developing countries, and developing countries account for more than 40 percent of U.S. exports of iron and steel and of electrical machinery and apparatus.

When developing countries experience severe economic difficulties, as they did in the early 1980s, demand for U.S. exports is reduced. In the early 1980s U.S. exports to Latin America fell by about a third in response to the debt crisis, and that drop is argued to have greatly increased the severity of the U.S. recession in 1982–83.[3]

In addition to its economic and geographical interests in developing countries, the United States also has a broader stake. Recognizing the poverty in many developing countries, many U.S. citizens believe that the United States, as a rich country, bears a responsibility to assist in economic development on humanitarian grounds. Moreover, most analysts believe that successful economic development is a necessary, if not sufficient, condition for the stable and peaceful evolution of the world economy.

In the past two years, another reason for concern has emerged. The countries of Eastern Europe and the Commonwealth of Independent States (CIS) have won independence and begun difficult transitions to democracy and a market economy. Their rapid and, to the extent possible, painless transition to democracy and reasonable standards of living is greatly in the interest of the United States. In the debates over how best to smooth the transition, questions surrounding the efficacy of foreign aid and debt forgiveness, the role of the multilateral institutions, and the desirability of relaxing restrictions on imports from those countries have arisen. The formulation of a more coherent U.S. policy is urgent on that score alone.

The purpose of this study is to examine the major instruments of U.S. international economic policy toward developing countries, including U.S. policies on foreign aid, the multilateral institutions, trade, and debt. Analysis of the impact of these policies and recognition of the extent to which they are at cross-purposes will, it is hoped, provide impetus for their improvement.

The organization of the work is as follows. Chapter 2 provides a brief overview of the evolution of U.S. international economic policy toward the developing countries after World War II. Although the purpose of this volume is not to analyze *why* U.S. policies are what they are,[4] or to provide a history of these policies, an understanding of the evolution of policy helps set the stage for what follows. In a sense, U.S. policy toward the developing countries was formulated at a time when they were relatively homogeneous and without much clout in the international economy. While economic policies toward developed countries were formed along functional lines, policy toward developing countries was based largely on foreign aid. As developing countries have evolved, becoming much more important and much less homogeneous, U.S. policy toward them does not appear to have been systematically reassessed.

Chapter 3 provides a summary of current understanding of the development process, focusing on policies of developing countries that are conducive to economic growth and on how the international economy affects growth prospects. Readers familiar with current thought on economic development and the policy reforms of the 1980s may wish to proceed directly to the subsequent three chapters, each of which deals with one of three major areas of U.S. policy toward the developing countries—foreign aid; the multilateral institutions, especially in regard to their role during the debt crisis; and international trade. Each of these policy domains has a sizable technical content that must be addressed if the relationship to economic development is to be understood.

Foreign aid, for example, consists of concessional assistance in support of development projects and programs in developing countries. The U.S. foreign aid program has been undertaken for a variety of motives, as the variety of categories of assistance attests. Any assessment of the effectiveness of foreign aid must take these diverse motives into consideration. Chapter 4 addresses these issues.

In addition to its bilateral aid program, the United States has also been the largest shareholder in the International Monetary Fund and the World Bank and a major shareholder in the regional development banks. As a result, U.S. policies affecting the behavior and performance of the multilateral institutions have also had a significant impact on developing countries. During the 1980s, when many developing countries encountered major economic difficulties and were unable to service their debts without international support, the United States actively formulated policy responses, influenced the activities of the multilateral institutions, and used a variety of policies to promote debt rescheduling and forgiveness. The impact of U.S. policies on the multilateral institutions, including their responses to the debt crisis, is the subject of chapter 5.

U.S. policies toward imports from developing countries affect their access to markets and the response of their exporters to changes in incentives. One of the critical considerations in assessing the net impact of U.S. policies toward developing countries is the relationship between foreign aid and official lending on the one hand, and trade on the other. U.S. trade policies affecting developing countries are the subject of chapter 6.

When a number of different agencies, with differing constituencies and objectives, are responsible for the formulation and execution of policy in a number of different areas, conflict among the effects of these policies is probably inevitable. Although some of those conflicts are discussed in the chapters dealing with aid, the multilaterals, and trade, this discussion remains somewhat abstract. Chapters 7 and 8, therefore, complement that material by examining the interaction of U.S. policies in two particular situations: the Caribbean and the Republic of Korea.

Chapter 7 provides an account of the Caribbean Basin Initiative (CBI), inaugurated by President Ronald Reagan in 1983. The CBI was a response to the economic difficulties of the Caribbean countries; improvement in their economic performance was deemed vital to U.S. interests. At the Reagan administration's request, Congress authorized and appropriated additional foreign aid for the CBI countries. However, trade, aid, and debt policies have often been at cross-purposes with the overall Caribbean initiative. These conflicts provide one concrete example of the incoherence of U.S. international economic policies.

Chapter 8 analyzes U.S. policy toward Korea in similar terms. Korea's enormous economic success is in part attributable to U.S. foreign aid extended in previous years. Korea is thus important to the United States as an example of what foreign aid, combined with appropriate economic policies in the recipient country, can achieve. Korea's continued economic growth is in the U.S. interest both because it is essential to the stability of Korean democracy and because Korea has become a "showcase" of successful U.S. foreign aid policy. Nevertheless, recent international economic relations with Korea, handled through the U.S. Trade Representative (USTR) and the Treasury Department, have been acrimonious. The United States has restricted some Korean imports and has strongly pressured Korea to liberalize its import policies and to appreciate the nominal exchange rate of its currency. The United States has advocated some of these policies even when they were clearly detrimental to Korean economic growth.

A final chapter, chapter 9, then summarizes the argument and calls for greater coherence among U.S. international economic policies to-