Managing the World Economy: Old Order, New Order or Disorder?

*by Graham Bird**

The New International Economic Order: An Overview. By P.N. Agarwala. *Oxford: Pergamon Press*, 1983. Pp.xiii + 351. £17.50. ISBN 0 08 028823 5.

Third World Strategy: Economic and Political Cohesion in the South. Edited Altaf Gauhar. *London: Praeger*, UK distributor Holt-Saunders, 1984. Pp.xvi + 220. £24.95 and £12.95. ISBN 0 03 069713 1 and 069712 3.

The New International Economic Order: Conflict and Cooperation in North-South Economic Relations, 1974–77. By Jeffrey A. Hart. *London: Macmillan*, 1983. Pp.xviii + 180. £25. ISBN 0 333 34525 8.

The Management of the World Economy. By Evan Luard. *London: Macmillan*, 1983. Pp.xxvii + 270. £25. ISBN 0 333 34236 4.

The Challenges of South-south Co-operation. Edited by Breda Pavlič, Raúl R. Uranga, Boris Cizelj and Marjan Svetličič. *Boulder, CO: Westview Press*, UK distributor Bowker, 1983. Pp.xii + 455. £21.75. ISBN 0 8653 601 5.

The Oil Crisis and Economic Adjustment: Case Studies of Six Developing Countries. By Andrew MacKillop. *London: Frances Pinter*, 1983. Pp.xi + 180. £16.50. ISBN 0 86187 301 7.

Controlling the Economic Future: Policy Dilemmas in a Shrinking World. By Michael Stewart. *Brighton: Wheatsheaf Books*, 1983. Pp.ix + 192. £15.95 and £5.95. ISBN 0 7108 0182 3 and 0187 4.

INTRODUCTION

In many key respects, the international economic order which characterised the 1950s and 1960s broke down during the 1970s and 1980s. An international trading system that had experienced considerable liberalisation became affected by growing protectionism, even though most of the new protectionism took the form of non-tariff barriers. At the same time the world's monetary system, previously based on the rules worked out at the Bretton Woods conference in 1944 and operating under the auspices of the institutions conceived there, effectively collapsed. The world moved away from fixed exchange rates towards flexible ones, and came to rely much more heavily than before on the private international banks as a source of balance of payments finance.

Along with – though not necessarily because of – the breakdown in key facets of the old order, the performance of the world economy began to falter. For the world as a whole, the rate of inflation accelerated, the level of unemployment increased, the rate of economic growth declined, and balance of payments disequilibria became much larger than those with which anyone had previously had to deal. This is not to deny

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that individual countries or groups of countries – the 'newly industrialising countries' for example – did quite well during the 1970s, but overall there was an observable deterioration.

These events generated a great deal of thought and discussion covering many aspects of economic performance. Two major topics of debate were, first, the chances of replacing the old Bretton Woods order with a new international economic order (NIEO) which would be less dominated by the industrial countries of the North; the second, the search for an explanation for the apparently quite rapid deterioration in the world's economic fortunes. Leading on from this second question was the additional issue of what might be done to improve matters.

The books reviewed here tend to fall into one or other of these areas of debate. However, the two questions are not independent. A major theme of the Brandt Report, for example, is the mutuality of interests between the South and the North, with increased real resource flows from the North to the South being seen as a means by which greater employment, higher levels of output and stronger export performance can be achieved in the North.

While there has been plenty of discussion of the issues mentioned above there has been much less solid achievement. The rise in protectionism has continued unabated, there has been little if any increase in real aid flows, there has been only slow progress towards an Integrated Programme for Commodities, there has been a continuing decline in the terms of trade of many non-oil primary-producing countries, and there have been no really fundamental changes in international financial arrangements.

Furthermore, while the economic achievements of the United States in the 1980s cannot be denied, it is still perhaps too early to say how durable they will be. In any event there is little evidence that recovery in the US has been transmitted to other industrial nations or to developing countries. While the strength of the dollar has provided foreign producers with a competitive advantage, the dollar's strength has, in part, been caused by the bond-financed fiscal deficit in the US which has pushed up interest rates world-wide, thereby deterring consumption and investment. Moreover, it has exacerbated the problems of those countries whose debt is based on floating interest rates. The kind of recovery pursued by the US may thus have been more contractionary in its world-wide implications than it has been expansionary.

Nor is there much evidence that the global balance of power has altered very much. While OPEC clearly exploited its position when there was a rising market for oil, subsequent events have shown just how quickly the bargaining strength of such a grouping can evaporate when there are no excess demand pressures. More broadly, the era of powerful commodity cartels foreseen by some commentators has simply not materialised and the relevance of the market as a principal determinant of political and organisational changes has been underlined. There have, of course, been some relatively minor achievements. Certainly there is a more general awareness of global distributional issues than prior to 1973. Furthermore, some modifications have been made to the operation of the international financial system, but this is hardly evidence of a NIEO – more the continuation of a trend that was well established long before the 1970s. A question arising from all this – and one which has been only partially answered above – is how can the lack of achievement be explained?

The rest of this article is organised around the questions that have been raised above. Where appropriate, the arguments and ideas contained in the books listed at the beginning will be drawn upon and commented upon, but what emerges is not a full critical review. Without doubt many of the books deserve much fuller scrutiny than space permits here.

MANAGING THE WORLD ECONOMY

World economic performance after 1973 caught economists with their theories down. Contrary to conventional economic theory which predicted an inverse relationship between economic growth and employment on the one hand, and inflation and balance of payments disequilibria on the other, economies seemed to be experiencing at the same time rising inflation, deepening balance of payments difficulties, increasing unemployment and falling economic growth. There seemed to have been a fundamental qualitative deterioration in economic performance.

It shows much for the inventiveness of economists that it was not long before not just one but a series of theories was being offered to explain what was going on. Suggestions included: first, that it was all to do with long waves in economic activity, or business and political cycles; second, that it was simply monetarism at the global level, with rising unemployment reflecting a response to faster inflation and an increase in the natural rate; third, that it reflected not so much excess monetary demand but falling real supply as the size of the producing sector relative to the service sector or government sector fell; fourth, that it resulted from changes in the terms of trade between primary products and manufactures, with rising primary product prices in the early 1970s leading to cost inflation in industrial countries and a demand-deflationary response; fifth, that it was evidence of the world economy's being in transition, adjusting to the emergence of the NICs; and sixth, that it was the direct result of the collapse of the Bretton Woods financial regime and the introduction of generalised floating. These explanations are not central to the books reviewed here, but two further propositions are.

The first is that the deterioration in global economic performance after 1973 may be linked specifically to the increase in oil prices in that year. The increase is seen as having been administered by OPEC, and as causing cost inflation and demand deflation. The latter is explained by the argument that the oil price rise redistributed world income away from high spenders, namely the OECD countries, towards high savers, namely, the OPEC countries, and thereby reduced the world's average propensity to spend. The oil price rise is also used to explain growing payments difficulties, the move to the market place as a way of financing payments deficits, the resultant debt problem, and so on. In short it is seen by its advocates as offering a fairly comprehensive explanation of macroeconomic aspects of the 1970s and 1980s.

Andrew MacKillop investigates the impact of rising oil prices on the economies of six developing countries. His book clearly catalogues the problems with which these countries have had to deal and the pressures for economic and social adjustment that have been generated by a worsening balance of payments situation. However, while enough evidence is presented to confirm that large changes in energy prices create serious problems for countries that rely on imported energy, it is another matter to attribute the entire spectrum of global macro-economic ills to energy-related factors. MacKillop wisely rejects such a temptation and argues that additional factors have been at work; indeed, the intention of his study 'was to show that the increase in oil prices was not the sole reason for the economic malaise of the developing countries'. The logic of this view is supported by the fact that falling oil prices have co-existed during the 1980s with a severe industrial recession. Surely rising oil prices and falling oil prices cannot both be used to explain recession. Nor can one ignore the argument that oil prices are not administered at all but instead are the result of world demand levels. On this view it was the expansion in aggregate demand in the early 1970s which caused oil prices to rise and the recession of the 1980s which caused them to level off. At any rate it would seem right to examine other factors in addition to oil.

The second of our further explanations maintains that many observed macro-economic problems reflect governmental economic mismanagement, albeit mismanagement set against a changing, and sometimes dramatically changing economic background. Failure to manage the world economy appropriately is the underlying theme of both Michael Stewart's and Evan Luard's books.

Stewart investigates in considerable detail what he sees as a neglected dimension of macro-economic policy, namely, the spatial and temporal aspects. To concentrate here on the former, he argues that economies have become much more interdependent over the last 15 years both through trade and, perhaps more so, through capital flows. Even flexible exchange rates, which are in principle supposed to insulate individual economies from the rest of the world, have in practice largely failed to do so. However, there has been no increase in the synchronisation of macroeconomic policy to match this increased interdependence. Instead governments have continued to formulate macroeconomic policy in a unilateral fashion. The result of this policy approach has been to impart a demand-deflationary bias to the world economy, since governments have been preoccupied with reducing inflation and avoiding balance of payments deficits. Any isolated attempts at expansion have encountered the hostility of the international financial community, the exchange-rate repercussions of which have led to their reversal.

The options for countries in this demand-deflationary environment are either to de-link themselves from the rest of the international community through a framework of trade and exchange controls, or to co-ordinate their policies more closely, thereby implicitly agreeing upon a particular distribution of payments disequilibria. Stewart, probably wisely, prefers the second course of action, though rightly he points to the lack of success that has been had up to now by world economic summitry. His hope is that disillusion with monetarism and concern about the high levels of global unemployment will provide sufficient incentive for a co-ordinated expansion. On the basis of the figures published by the IMF in its *World Economic Outlook*, there is little real sign of any change as yet amongst many of the most powerful economic nations. Fiscal impulses appear to be fairly uniformly contractionary – although the US is something of a special case. As Stewart implies, the lack of a positively co-ordinated expansion seems almost inevitably to lead to an uncoordinated, yet fairly universal, recession.

While Stewart leaves to one side the precise mechanisms and organisational structures under which co-ordinated expansion might be arranged, such arrangements are a central concern of Luard's book. His proposals amount to a multi-faceted programme of international institutionalisation. In order to encourage balanced world growth there would be 'a kind of international economic council' which 'would meet, at least quarterly, to discuss the state of the world economy'. To oversee investment and aid there would again be a 'new body ... that would maintain a general oversight of the development process all over the world and of the transfer of resources ... taking place for that purpose'. For trade 'a new joint supervising council' would bring together representatives of GATT and UNCTAD and would 'set up new joint committees or activities where appropriate'. For the international banking system 'better international supervision ... is ... required' and the IMF needs to be expanded. Similarly there would be a new International Commission on National Resources, a new international energy agency, and so on.

Without doubt there are times when it is appropriate to argue for and feasible to establish new international agencies. Blanket acceptance of the institutional status quo is clearly a misguided philosophy. However, it also needs to be recognised that forces which generate what may be seen by some as the inefficiencies and inequities of the existing institutional system are also likely to inhibit the establishment of new agencies designed to remove them. Having identified deficiencies, the easy and soft answer is, in many respects, to propose a new agency which will miraculously correct them. What is more likely in fact is that the new agency will never get off the ground because of political wrangling, or that if it does, it will be subject to many of the same deficiencies as those that it replaces or complements. Furthermore the proliferation of agencies may simply obscure many of the important issues, particularly if time is spent arguing as to whose responsibility it is to do what. Even apparently clearly-defined terms of reference do not eliminate this possibility, as experience with the IMF reveals.

A more interesting question is the political economy of institutional operation and reform. How do institutions work, how do they reach decisions, why do they often do things that to outside observers seem misguided, and why do they often seem inflexible and unresponsive? Once these issues are better understood there may be scope for improving the institutions that already exist rather than replacing them with others which may turn out to be no better.

Furthermore, the scope for institutions to manage the global economy is strictly constrained by both internal and external factors. Internally there are bound to be bureaucratic and administrative delays in decision taking which mean that when the decisions become effective they may no longer be appropriate. For example, attempts to use SDR creation in a counter-cyclical fashion may be subject to a lag structure which would result in variations actually being pro-cyclical.

Even where decisions that might be generally seen as sensible are taken, it is difficult for institutions to make them effective if the outside world is reluctant to accept them. For example, there are good grounds for establishing the SDR as the world's principal reserve asset, and the IMF has set this as a target for international financial policy. However, the world has in practice moved towards a multiple currency reserve system rather than towards the SDR. It is clearly not enough merely to take the right decisions; the means by which they can be made effective also needs to be examined.

In conclusion, the benefits from a new spate of institution building are unlikely to exceed the costs. In circumstances where world economic summit meetings fail to articulate and activate certain policies it is unlikely that an international economic council will achieve much more. What is needed is a change in the attitudes of the participants at such forums. It would be nice to think that scholarly works such as Stewart's and Luard's have a part to play in such a process but one may remain sceptical.

THE NEW INTERNATIONAL ECONOMIC ORDER

The New International Economic Order figures as the title of two of the books, one by Jeffrey Hart and the other by P. N. Agarwala. Hart sets out to explain the policies of the major participants and the outcomes of the negotiations between 1973 and 1977. He focuses on a series of questions: why did the negotiations assume importance; why did the developing countries manage to maintain greater unity than the developed countries; why did the negotiations fail to achieve much; and finally what are the prospects for the future?

While Hart's book is a fairly narrow study of the politics of economics, Agarwala's is a wide-ranging overview of all aspects of the NIEO. Indeed it synthesises the main findings of a 15-volume study published by UNITAR in collaboration with the Centro de Estudios Económicos y Sociales del Tercer Mundo (CEESTEM) in Mexico, which covers regional issues, sectoral issues – trade, industrialisation, finance, food and agriculture – and socio-cultural and political-institutional issues, as well as general surveys on the objectives of and obstacles to the NIEO.

From the range of questions that these texts raise, two will be examined here. One relates to the lack of achievement in terms of fundamentally restructuring the international economy and altering the distribution of power within it. The other concerns the alternative of South–South co-operation.

A number of factors may be combined to help explain the lack of success, although in short the answer is that the bargaining position of those seeking a new order was insufficiently strong. First the North–South distinction is too simplistic. It cannot be argued that the South, containing as it does OPEC, the Newly Industrialising Countries and the low-income countries, is an homogeneous entity. Different countries within the South – and indeed within the North – have different interests and different views as to how these interests are likely to be best served. Even for individual Southern countries or groups of countries there may be internal inconsistencies in their position with regard to reform. Debt relief, for example, may have some short-term appeal, but at the same time recipients of such relief will worry about damaging their long-run creditworthiness. Or again, while many developing countries may stand to gain from a more structured system of international liquidity creation based on the SDR, they may be reluctant to give up the flexibility that the Euro-currency market offers, or to abandon the scope for reserve management.

Second, the international environment most conducive to evolutionary reform is a structured one. In practice the world moved away from a 'system' in the 1970s. The old order was replaced by no order rather than a new order. Yet in the mid-1970s this move was probably more the result of expediency than of deep ideological beliefs in the superiority of the market.

Third, commodity market conditions changed. There was a move from excess demand to excess supply, and from a sellers' to a buyers' market. To the extent that bargaining strength reflects market position, it is not surprising that the momentum for a NIEO initially generated by the increase in oil prices subsequently petered out. In effect the responses of the developed world to the claims for a new order were to move into recession, economise on the use of oil, adopt more inward-looking trade policies, and thereby undermine the bargaining strength of the South. Of course this was probably not the motivation for these policies. Instead they reflected a pre-occupation with reducing the rates of inflation and payments deficits.

With respect to inflation, many elements of the NIEO, such as the SDR link and the Integrated Programme for Commodities, were seen by countries of the North as making it worse. Furthermore, it is interesting to note that the increase in oil prices which stimulated the South's interest in a NIEO, and which initially improved their bargaining position, also contributed to world-wide inflation and to attitudes which were hostile to the proposals for a new order.

As far as the balance of payments is concerned, it may be noted that measures taken to strengthen the North's position almost inevitably weakened the South's and pushed many developing countries into a situation where they had little option other than to turn to the Fund, an institution which many of them see as a bastion of the old order. The strength associated with being a surplus country and one of the Fund's creditors was really attained only by Saudi Arabia – a country whose attitude towards the NIEO might be seen as somewhat ambivalent. It is only under the threat of a debtor's cartel that deficit countries may improve their bargaining position and, as already explained, debtor countries may feel that carrying out such a threat would involve more costs than benefits in the long run.

Fourth, the 'mutuality doctrine' that is so much a part of some (though by no means all) of the proposals for a NIEO has essentially been rejected by governments of the North. It is seen as being based on Keynesian notions that have been rejected in favour of a more monetarist approach to economic management. In any case, governments have no doubt viewed many aspects of the NIEO, for example, increased aid, as politically infeasible in circumstances where the thrust of domestic economic policy is contractionary.

Given the rejection of mutuality, Northern governments have seen nothing for them in the NIEO, particularly after oil became of less pressing concern. Their short-term interests appeared to be best served by participating in discussions from which nothing much would emerge. What has in fact happened is therefore consistent with the view that the balance of economic power has not changed and that the interests of the most powerful groups continue to dominate.

FUTURE PROSPECTS: THE SOUTHERN ALTERNATIVE

The above factors make it unlikely that a 'grand design' approach based on global negotiations will prove successful. Indeed there is a fundamental 'Catch 22' dilemma. For the South to be in a strong bargaining position it needs to have been relatively successful economically. However, economic success under the old rules will reduce the desire to change them. The motivation to change the system will only be strong in conditions where the South's bargaining position is weak.

If there is not much mileage left in global negotiations involving the North and South, what about the scope for South–South co-operation? In one sense the heterogeneity of the South in terms of comparative advantage provides the opportunity for intra-South trade and investment, yet by the same token the heterogeneity of interests makes it likely that a South–South dialogue will generate as few positive benefits as the North–South one has done. When, for example, thought is given to schemes for an exclusively Southern version of the IMF or the World Bank, a key question is where is the finance to come from? The short answer is that it will have to come from countries that have been relatively successful under existing arrangements. But will these countries be anxious to foster Southern arrangements? They may of course be rather more interested when they themselves become less successful, but then they are unlikely to possess the necessary finance.

The conclusion is that while frustration with the lack of action on the North South front is understandable, the chances of success on the South–South front can easily be exaggerated. It should be emphasised that this general conclusion does not mean denying that there may be opportunities for greater Southern co-operation than has been achieved in the past. What it does imply, however, is the need to get away from the banner-waving type of advocacy of vague South–South solutions and towards a more reasoned and thorough analysis of specific proposals for reform. One cannot escape the fact that attempts to apply the logic of co-operation, as can be found in various Southern trading blocs, have often been rather less than successful. It should not simply be assumed, therefore, either that Southern solutions are automatically desirable on economic grounds – some may be, others may not – or that they can easily be made to work.

Two recent books which examine various facets of the Southern solution are the compilations edited by Altaf Gauhar and Breda Pavlič and others. The former brings together various articles previously published in *Third World Quarterly* and covers a range of issues. Both illustrate nicely, and in various ways, the large gulf that has to be bridged between the desire of some commentators for more co-operation within the South and the practicalities of actually specifying and implementing reforms.

CONCLUDING REMARKS

Does all this mean that talk of managing the world economy and of establishing a NIEO represents just so much wishful thinking by their advocates? Is the world economy doomed to muddle along in a disordered fashion, lurching from crisis to crisis? Not necessarily. There are alternative scenarios which may not be completely implausible. For example, dissatisfaction with flexible exchange rates and concern over unemployment could result in closer policy co-ordination and in a resurgence of neo-Keynesianism. To the extent that such policy changes were successful, they might create an international environment more conducive to at least some of the reforms that are now elements of the proposals for a NIEO. However, these reforms seem more likely to be made in a piecemeal fashion, much as they have been in the past.

The most probable response to the disorder of the 1970s and early 1980s would therefore seem to be a return to a version of the old order – albeit somewhat modified – rather than the establishment of a new order of things. Yet this would not imply a complete failure for the Third World. Indeed the return to a more structured international financial system, a reduction in the variability of exchange rates, an increase in the rate of economic growth, falling interest rates, increased world trade, and reduced protectionism, would all be to the general advantage of developing countries. A case may therefore be made that in present circumstances it would be more sensible for developing countries to focus on trying to encourage such changes in the world economy than to continue with claims for a NIEO which themselves stand almost no chance of success but which may reduce the likelihood of the other reforms being introduced. Rhetoric, no matter how fine, and plans, no matter how grand, stand much less chance of improving the lot of the population of the Third World than a more hard-headed and pragmatic approach which shows a keen awareness of what is, and what is not, possible.