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EFFECTS OF PRESIDENT NIXON'S AUGUST MEASURES ON DEVELOPING COUNTRIES

A Note by the Overseas Development Institute

In August President Nixon announced sweeping measures to strengthen the US economy, improve its balance of payments and 'protect' the dollar. Four of the measures bore directly on the US external position: 1) the 10% aid cut, 2) the 10% Job Development Credit, 3) the 10% import tax, and 4) the suspension of full dollar convertibility. While all these were intended to make a direct contribution to restoring external equilibrium, the latter two also had the much more ambitious objective of forcing other countries to take measures which would make it easier for the US to achieve, and maintain, the desired external equilibrium.

In the confusion immediately following the announcement, which contained several important ambiguities, the significance of the measures was difficult to gauge. Since then a number of points have been clarified, and the process of international consultations and adjustments has been set in motion. Although the most important adjustments are still to come, it is now possible to make an interim assessment of the importance of the measures for developing countries (LDCs).

1. The Aid Cuts

The original announcement referred merely to a cut of 10% in "foreign economic aid". Since then a few details have been added, the most important being that the cuts were intended to fall on the aid budget now before Congress, and not on other aid programmes which are approved outside the main budget, such as Food Aid, Peace Corps and Export-Import Bank loans. The economic aid budget for 1971/72 originally submitted to Congress amounted to $3,000m, so a 10% cut would have come to $300m. Figures for the other categories of aid are not yet available, but in 1969/70 for example, total US aid commitments as reported to the Development Assistance Committee of OECD (aid budget plus other aid) came to $4,330m, with commitments under the main aid budget amounting to $2,375m, or only 55% of the total. The proposed 10% (or $300m) cut should be seen in this wider context(see table 1).

A final decision on how the main aid budget is to be trimmed by $300m has yet to be announced. Meanwhile, on the multilateral side, the Administration is seeking Congressional authorisation to make contributions to the International Development Association, the Inter-American Bank and the Asian Development Bank at levels originally envisaged, but the request for an additional US capital subscription to IBRD is likely to be dropped (see Table 1). On the bilateral side, it has been announced that Latin America will be exempted from the cuts, and there has been a strong hint that the exemption will apply also to security-related aid for Cambodia, Laos and South Vietnam. The implication must be, therefore, that the brunt of any eventual cuts will be borne by other countries in Asia and by Africa.

While the Administration's decisions on where specific cuts are made will determine how individual recipients will be affected, its proposal on the overall size of the cut now looks like being overridden by Congress. Already the Senate Foreign Relations Committee has proposed cuts of over 20% in the bilateral aid budget (table 1, categories 2,3), and the final aid bill is likely to be reduced by considerably more than the Administration's proposed $300m.

2. Job Development Credit

Under this provision, US machinery and equipment will receive *de facto* protection equivalent to a 20% tariff as a result of the tax credits which US companies re-equipping with US made machinery, etc. are to receive. While this will affect only a minute proportion of LDC/US trade, it may be of some importance in the longer run if it helps to thwart the development of industrial exports from some of the industrially more advanced LDCs.

3. The 10% import tax

The original announcement referred only to an "additional tax of 10% on goods imported into the US". This was subsequently defined to mean a tax of 10% on the landed value (not on the existing duty) of "all dutiable imports which are not already subject to quantitative restrictions". Cotton textiles were later explicitly exempted from the tax, even though they were not fully covered by quantitative restrictions. At the same time, the US threatened to impose quantitative restrictions on non-cotton textiles unless Asian exporters were willing to agree to 'voluntary' export restraints. In mid-October agreement was reached with Japan and three developing countries, Hong Kong, Taiwan and South Korea, for voluntary export quotas. Under these, the three developing countries would be allowed to increase exports of non-textile products by up to 7% a year for 5 years, from a base period of exports reached in the 12 months April 1970 to March 1971. The choice of this base period will mean a drop in exports in the next 12 months, followed in subsequent years by increases up to the envisaged rate. The agreement has resulted in the 10% tax on non-cotton textiles being withdrawn; the 'concession' will apply to all exporters without discrimination.

About 26% of total imports into the US come from LDCs; of total imports from LDCs 23% are now subject to the 10% import tax. Because the tax surcharge is not applicable to the major categories of LDC exports - food, raw materials and textiles - it affects only a small proportion of most countries' exports to the US, and a still smaller proportion of their world exports. A few countries, however, face disproportionate effects. Mexico, Hong Kong, Taiwan, and South Korea between them account for 70% of total LDC exports subject to the new import tax; this represents one third of their total exports (see table 2). While these figures give an indication of the incidence of the import tax, its actual effect on export earnings cannot be easily assessed. This will depend on the length of time that the tax will remain in force, and, while in force, on the competitive situation of the products in question.

Despite the small number of LDCs for which the tax is important, all LDCs have taken a strong concerted line against it. At the GATT Council meeting of August 26, the 25 developing country representatives criticised the tax on the grounds that it contravened Article 37, under which contracting parties are to refrain from taking measures prejudical to the orderly development of exports from LDCs. Later, at the September meeting of the UN Trade and Development Board, the LDC group moved that their members should be exempted from the tax. This resolution, and a similar one put forward by the Latin American group asking for a waiver for Latin America, were rejected by the US.

4. Suspension of dollar convertibility

In itself, this action was of little immediate consequence to LDCs. Its major significance lies in the fact that it was the opening shot in a campaign aimed at forcing major readjustments in exchange rates and reform of the rules of the existing international monetary system.

The immediate American aim was to force revaluation upwards of a number of other hard currencies in order to avoid a formal dollar devaluation (increase in the dollar price of gold). Since the severance of a direct link between major currencies and gold via the US dollar, a régime of floating currencies has been in force, and a number of hard currencies have been allowed to float upwards, thereby at least partly fulfilling the aim of the US initiative. The readjustment process is not yet at an end, but insofar as several currencies, including the Yen, Mark, Guilder and Pound have appreciated in relation to the dollar, the financial positions of developing countries have been affected in a number of ways: the purchasing power of aid, the real value of currency reserves and the burden of debt obligations have altered; the competitive positions of LDCs have changed in relation to individual developed countries and between themselves; the value of contractual agreements has been affected, as also the mechanics of a number of commodity agreements. Moreover, the hard currency realignments have forced LDCs into decisions on their own exchange rates, in particular as to whether they should maintain the existing dollar value, or 'float' with currencies, such as Pound or the French Franc, with which they have had a traditional link, (see Appendix for list of Sterling Area countries which have decided to float with Pound).

The parity changes have been only the first stage of major international economic readjustments. The lines of an eventual agreement are still blurred. It is clear, however, that the eventual outcome, and the processes by which it is reached, will have widespread repercussions on all countries, including the LDCs. It is natural that the LDCs wish to have a say in any discussion leading up to new arrangements, and they have put their case for this forcefully through the UN Trade and Development Board. However, the OECD countries have rejected UNTAB as a proper forum for substantive discussion of international monetary questions, preferring to keep the negotiations in the Group of Ten, the OECD and the IMF, in which they have the decisive voice. It seems likely, therefore, that whatever arrangements will emerge, the LDCs will have played only a marginal role in the deliberations.

The central aim of these deliberations is to construct a system which will allow for orderly expansion in world trade generally. While the outcome is important for all countries, the LDCs have a much greater interest in measures which would allow them better access to resources, either through trade or aid. There is now a real danger that the preoccupation of OECD members with problems of economic adjustment between themselves will once again distract attention from those other issues of more central importance to the less developed members of the world community.

Appendix

Table 1

Categories of US economic aid
($m)

		Aid Request 1971/72	Commitments or Appropriations 1969/70
A.	**The Aid Budget**		
	Foreign Assistance Act		
1	Contingencies	100[1]	124
2	Supporting Assistance	778	518
3	Development Aid	1,175	1,235
	Sub-total (1-3)	2,053	1,877
	International Financial Institutions		
4	IBRD Capital subscription	24[2]	-
5	IDA 3rd Replenishment	320[3]	160[4]
6	IADB	600[3]	300
7	ADB	33[3]	20
	Sub-total (4-7)	977	480
B.	**Other aid programmes**		
8	Peace Corps	...	90
9	Food Aid	...	1,190
10	Other	...	95
11	Export-Import Bank	...	615
	Sub-total (8-11)	...	1,990
12	Grand total	...	4,327
13	Total aid budget	3,030	2,357
14	Aid budget as % of grand total		55%

Notes:
1. Includes provision for military contingency aid.
2. Paid-up portion (10% of $240m)
3. One-third of total authorisation requested for 1971/2 - 1973/4.
4. Final instalment of three-year contribution totalling $960m.

Table 2

Incidence of Import Tax

(ODI Estimates)

From:	Total LDC imports into US (1969, $m)	Share originally subject to tax (%)	Share Subject to tax since non-cotton textile exemption (%)	Share of LDC world exports now subject to tax (%)
Western Hemisphere	5,162	24	24	9
of which:				
Mexico	(1,029)	(60)	(59)	(45)
Asia	3,378	40	22	5
of which:				
H. Kong	(815)	(90)	(59)	(28)
Taiwan	(388)			
S. Korea	(291)			
Africa	792	-	-	-
Other LDCs	232	-	-	-
All LDCs	9,564	30	23	5

Note: - signifies zero or negligible

Currencies of Sterling Area LDCs 'floating' with the Pound

Barbados, British Honduras, British Solomon Islands, Caribbean Associated States & Colonies (Eastern Caribbean Currency Area), Ceylon, Cyprus, Falkland Islands, Fiji, Gambia, Ghana, Gibraltar, Gilbert-Ellis Islands, Guyana, Hong Kong, Jamaica, Mauritius, Nigeria, Pitcairn, Sierra Leone, Tonga, Trinidad and Tobago, Zambia.