Framing Development in the Third World: An Analysis of US Foreign Economic Policy during the Cold War

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Abstract

This paper traces the evolution of economic development in the Third World from the end of the Second World War till 1990 to understand how the US foreign economic policy was a crucial factor in shaping developmental strategies. The methodology adopted for this paper involves the use of historical and critical analyses of relevant events and policies during the Cold War period, with a focus on outlining the trajectory of international development linked with American values and interests. The paper begins by examining the nature of the Third World independence movements and the power they expressed following the end of European imperialism. The state-led model of development which the Third World adopted after independence was a direct consequence of the imperial experience. The initial economic boom coupled with a welfare orientation during the 1950s and 60s aided by the US was primarily in response to counter the threat of communist Soviet Union. As a result of the Cold War politics, many governments in the developing world received monetary support from the West as well as autonomy in policymaking. It is argued that the 1970s was a turning point bringing a radical political and economic shift towards neoliberal policies as the global economy faced recession owing to various factors. This change in the US stance impacted the developing nations negatively as many plunged into debt crises allowing the West and the related economic instruments significant bargaining power to impose economic conditions as the Cold War, too, came to an end. The paper concludes by emphasizing that the continuous underdevelopment of developing countries owes to the enduring American influence on international development.

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Introduction

The intricate evolution of economic development spanning the post-Second World War era up to 1990, depicts the pivotal role played by the United States' foreign economic policy in shaping the developmental policies of the Third World. The fundamental aspect of this influence is reflected in the aftermath of independence movements that emerged in response to the European imperialism. A key focus is on the state-led model of development embraced by the Third World, a model directly influenced by their experiences with imperialism. This model adopted initially in the 1950s and 60s reveals a narrative characterized by economic prosperity and welfare initiatives, driven significantly by the support of the US, the dominant global power post-1945, and as a response to the perceived threat posed by the communist Soviet Union during the Cold War. However, a pivotal juncture emerges in the 1970s, marked by a radical shift toward neoliberal policies driven by US considerations, a transformation triggered by the economic turbulence of the 1970s. This shift, had profound repercussions for developing nations, contributing to a debt crisis that granted the West substantial leverage to impose economic conditions as the Cold War drew to a close.

The Cold War Context and the Long Boom: Shaping Post-Colonial States' Pursuit of Modernization and National Development

It is essential to discuss the context of the Cold War and the long boom in order to make sense of the efforts brought forward by the post-colonial states after 1945 to enhance modernization and national development. Right after the end of the Second World War, there was renewed hope with respect to the emergence of a new phase of world peace and order. The American-led establishment of the Bretton Woods system for economic cooperation in 1944 and the United Nations in 1945 were evidence of that renewed optimism. It was clear that the

US was to be the dominant actor in these international organizations given its relative standing. Unfortunately, the honeymoon period after the war was short-lived and in 1947 the relationship between the West and the Soviet Union was on the verge of breakdown leading to the Cold War.

In 1946 the Soviet Union established puppet regimes in Eastern Europe to prevent American efforts aimed at the containment of communism after the war to reach its sphere of influence. Germany had already been divided between East Germany (Soviet controlled) and West Germany (US controlled). The Marshall Aid funded by the US and aimed at economic revival of Europe, was accepted by the Western European countries including the United Kingdom, France, Italy, and West Germany, though it was available to any European country.

China was able to overcome Japanese occupation with American assistance during the Second World War; however, it fell back into a civil war which was ultimately won by the communists in 1949. This along with the Korean and Vietnamese communist victories further heightened tensions during the Cold War, making the communist threat the center of US foreign policy.[i] The US was militarily involved in the 1950-53 Korean War whereas it used economic tools like the Marshall Plan to counter communism in Europe though this was not the sole purpose of the Plan. The vast surpluses of capital that America possessed after the Second World War sought new avenues for profitable investment, which was another reason behind American economic support to the non-communist regions. Moreover, the US was looking for new partners for promoting international trade, in particular states and societies, able to purchase American products to resist economic recession.[ii]

Initially, most regions of Africa and Asia were largely ignored as part of the US aid policy, aimed at containing communism, which was primarily focused on Europe, Japan, Israel, Korea, and South America. The US was spending four percent of its Gross National Product (GNP) as part of the US aid policy under the Marshall Plan; in comparison, the country spent 0.18 percent of its GNP in 2018.[iii]

The Soviet Union in a bilateral context presented a serious military and ideological threat to the US but in terms of economic prowess, the threat was not substantial. Nevertheless, capitalism's shortcomings were well understood, especially in the context of the mass appeal communism possessed which was evident through its spread. The US was supportive of the free-market system, evident by its post-war economic efforts and intended to pursue it in the long run but the ideological and military compulsions prompted the US policymakers to strategize accordingly. The US tried to integrate the idea of 'even development' where the intent was to moderate and alleviate capitalism's natural inclination towards uneven development as part of its economic policy.[iv]

In a free-market system, it is inevitable to have winners and losers at every level of activity. This natural outcome of free market prompted the US and its allies to make necessary changes in policy to address communist elements locally and globally. The plan was to compensate the marginalized in the system through state intervention which meant improved welfare security. Western governments invited trade unions to engage and develop measures with the state and private sector to address related problems. At the national level, Keynes-inspired Western governments and the US strove to create policies which promoted and protected industries even if it meant that individual US firms might be at a disadvantage in the short-to-medium term. Internationally, the role of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), later part of the World Bank Group (WB), was focused on stabilizing the advanced economies so they could move towards economic liberalization gradually.[v] The General Agreement of Trade and Tariffs (GATT), for example, aimed at trade liberalization promoted a state-driven idea of liberalization where they opened up their respective economies while retaining control over the extent. The policy of even development was also presented to other countries, in particular, those who were essential to the cause of Cold War. Countries in East Asia like Japan, South Korea, and Taiwan were afforded to undertake major land reforms without the US interference after 1945. But others were not so fortunate, particularly countries in Central America where US corporations were protected, and governments were overthrown through direct military interventions to tackle the communist threat.

As far as the communist states were concerned, they, too, were keen to demonstrate the capacity and efficiency of state-led or command economy. The Soviet Union and its allies particularly in Eastern Europe were actively engaged in efforts to industrialize and to be able to compete with the capitalist bloc in order to keep up with the arms race that was one of the key features of the early Cold War period. This period was the highest point of command economy though China's economic pathway was rather unsettled and unpredictable in the 1950s and 1960s.[vi]

Postcolonial Dilemmas: Decolonization, Anti-Colonial Movements, and Development Strategies

The European dominance surely came to an end after the Second World War along with the Japanese imperial adventurism. Two of the remaining major colonial powers were exhausted after the war. The United Kingdom was so depleted due to the war and the colonial burden that India was bound to gain independence which it did in a bloody, hasty partition in 1947. As for France, it was able to remain in brief control of what today is known as Cambodia, Laos, and Vietnam, but its legitimacy was severely weakened. In Africa, independence movements emerged swiftly but remained non-threatening until the 1950s.[vii] European control was almost negligible by the mid-1960s as majority of the colonies they held were now independent states except for a few settler colonies in Africa where ultimately political movements resulted in armed struggles.

The right of self-determination is enshrined in the United Nations (UN) charter and was amongst the defining themes of the twentieth century. One thing that was common between the US and the Soviet Union was their strong opposition to European colonialism, despite their conflicting ideologies and interests. But the vacuum created by the European departure in Asia and Africa was to be soon filled by the Cold War politics trickling down these regions through proxy wars and puppet regimes. The anti-colonial movement in Vietnam, for example, became ever so complicated and protracted due to the Cold War rivalry as was the case with Korea. Eastern Europe had already served as a prototype for the Soviet Union and had autonomous regions like Central Asia, which many have argued were no less than colonial possessions. Similarly, the US had Philippines, Central America, and later Vietnam as its holdings. Such policies were akin to neocolonialism.

The nature of these anti-colonial movements and their roadmap for overcoming the negative effects of colonialism are important aspects of national development. There were multiple shades of these movements. Some were strongly influenced by Marxist ideas and promoted a socialist agenda; others were less ideologically driven and were rather indigenous in nature. Despite the differences, all movements were strongly attached to the notion of nationalism and were focused on gaining political autonomy as a prerequisite for overcoming underdevelopment, which was seen as a result of colonialism.[viii] The movements saw the pathway to economic prosperity as starting with development policies aimed at serving local people's needs rather than those of the imperial masters.

Unfortunately, many of these independence movements were controlled by a minority, often the national elite. These elites were largely composed of the remnants of the traditional authorities and were essential pawns for the colonial powers to administer these regions effectively. Since the elite were the beneficiaries of the limited opportunities to gain privileged education, they often became loyal to the colonial rulers only to be disappointed with their empty promises of economic equality and development.

In addition, the experience of the national elite under an authoritarian colonial political entity considerably impacted their understanding of how political authority could be implemented in the postcolonial period. This made them not much different than their colonial predecessors, yet they blamed the colonial setup for underdevelopment as well as their failure to reform their countries. Interestingly, most of the independence movements were diverse in nature, with varying economic, political, and ethnic backgrounds. But most often the elites had developed an inherent disliking for local and traditional values which were deeply rooted in the masses and had rather 'internalized colonial values' as Franz Fanon describes. The tussle, according to him and like-minded thinkers, was as much about gaining political and economic autonomy as it was about decolonizing the mind.[ix] The working class was in some cases, like India, mobilized against the colonial rule, but its role was primarily that of foot soldiers that lacked resources and organization. On the other hand, if the working class became organized and its leadership sought to develop autonomy beyond their standing in the independence context, it would raise suspicions about its objectives and agenda. This was observed even among the many Marxist-inspired movements including the Chinese Communist Party (CCP), for their model was inspired by the Soviet communist thinking. In short, strong national leadership could not materialize under colonialism.

Given such circumstances, the anticolonial movements were very much status-quo-oriented with their objectives hinged upon pursuing a top-down approach that sought power in the name of development. Though there existed marked variations in their overall approaches to achieve economic development, most adopted the policy of Import Substitution Industrialization (ISI) after seeking independence. The idea under ISI was to generate and implement economic surpluses via taxing the agriculture sector, bring in foreign exchanges through increasing exports, and use the capital to purchase modern machinery from the West for infant industries. In addition, they imposed tariffs on foreign goods and launched schemes to promote exports as part of the package.[x] Moreover, the newly independent states also sought financial assistance from international banks or foreign governments as currencies remained tied to the US dollar.

The strategy of ISI, which required greater state role in economic affairs has been criticized for many decades for its inability to generate economic development. However, it is essential to inquire whether any alternatives were available during the time. Especially given the context that indigenous ideas were subject to suppression during the colonial period, to initiate a development strategy where the role of the state was to be sidelined did not fit well. Moreover, the economic revival and rise of Japan and its former colonies, Taiwan and South Korea are success stories of a state-led development strategy. Though we can also argue that the above-mentioned countries adopted a hybrid approach incorporating export-oriented industrialization as well, there were other countries in regions like the oil economies of the Middle East and even in Africa and Latin America that looked promising to begin with until the 1980s. Looking back, one can blame the current developmental problems on the states' inability to deliver; however, to be fair, external factors played a major part in adding to the woes of the Global South, in particular, undermining the developmental capacity of the states. Furthermore, the primary issue for the third world has been its inability to translate early success into permanent progress.[xi]

There is no doubt that the external factors played a major role in preventing progress from materializing in the developing world. Nevertheless, the biggest predicament facing even those states which were performing well and sought to kick-start development in the 1960s and 1970s was their inability to generate economic surpluses and be able to multiply the gains in a productive fashion to bring about prosperity and social change in the development context. In Africa, the peasantry were the biggest losers. African governments pressed the working class especially the farmers in order to generate economic profits, but this did not produce the desired result of a dynamic industrialization roadmap. Consequently, most of the surpluses went towards what has been described as 'easy import substituting industrialization,' a simple process of making primary products.[xii] Moreover, the plans to shift towards value-added products or manufacturing over time were often poorly managed. As much of the economic surpluses were driven towards subsidizing the price of food for the urban workers and servicing the noticeable lavish consumption of the elite class. The peasantry in Africa received the least benefits, and, as a result, they reduced their export production and also pursued strategies to evade government taxation. The state, on the other hand, was unable to hold off such practices given its constraints and inability leading to what has been described as perverse growth of the development path.[xiii] In consequence, by the 1970s, this led to decline in demand for African primary goods and the state had run out of options for generating surpluses any further. The reliance on foreign aid for African countries began to swell, and it served as their functional substitute for revenue ,[xiv] a trend that continues to date.

In other parts of the world like Latina America, the critics of state-led development have recognized the problem associated with the model. During the interwar periods, it was observed that states like Brazil, Argentina and Mexico had made economic progress largely due to state support and underwent a phase of industrialization till the 1970s. Interestingly, the advanced economies during the same interwar period were undergoing a sustained recession which arguably helped Latin American countries reduce economic dependency and contributed to their industrial production. Conversely, the economic gains and industrialization efforts did not bear fruit and were unable to leave a mark on the international market largely due to their uncompetitive nature. This weakness was further exposed during the economically turbulent decade of the 1970s which saw a reduction in demand globally. In addition, the national industrial efforts did not generate products that could replace the luxury goods produced by the Western economies to which many elites were addicted. Economic inequalities were on the rise in Latin American societies as they developed an embedded urban preference undermining socio-economic development of the rural areas. In direct comparison with East Asia, the authority and interests of the rural landlords remained intact despite the various attempts at land reforms which failed. Increasingly, countries in Latin America became dependent on American financial assistance and foreign banks to boost their economies. Latin American ruling class dependency grew to a degree where the US was directly involved in national politics and decision-making that curtailed national sovereignty.[xv]

The Economic and Political Turbulence of the 1970s: Shifting Global Dynamics and Neo-Liberal Transformations

The onset of the 1970s brought about economic crisis not only for the US but also for the global economy. Besides, the continuation of the Cold War made it more complex. The Western European countries had moved beyond the phase of recovery after the Second World War and into a period of constant economic growth. Japan was now among the top advanced economies, and the US could feel the pressure of its even development policy undermining its competitive advantage. The US by now was faced with a negative balance of trade, importing more than it could export, and the fruits of labor movements in the advanced capitalist economies were now resulting in declining profits.

In order to promote exports, the Nixon presidency decided to end the fixed exchange rate system in 1971, which had been linked with the US dollar since 1945, whereby exchange rate with other currencies was fixed. The value of the US dollar was tied to the US gold reserves to maintain its value. The decision to end this was taken as the US could no longer bear the role of guarantor in the global economy as it faced increased economic competition, burden of domestic social programs, and cost of the Vietnam War, which continued to hurt the economy. Moreover, the oil crisis of 1973 following the Arab-Israel war, led to rising oil prices as well as the end of the fixed exchange rate system, which brought the long boom to an end. The Global North now faced an economic recession which would go on to have severe economic repercussions for the Global South as well. This was a period where global economy saw a rise in protectionist policies, and ad-hoc regulation of economies was now a more apparent trend.[xvi]

In the Cold War context, the decade was one of political and military defeat for the Western Bloc as the US forces eventually withdrew from Vietnam, making it a unified communist state. In other parts of Asia and Africa, Marxist movements were able to secure power and in some cases were driven by a socialist agenda. As for Latin America, the US continued to intervene in its domestic affairs and overthrew an elected socialist government in Chile in 1973 as insurgencies continued to rise in other parts of Latin America.

The communist bloc headed by the Soviet Union and its allies had begun to show signs of economic slowdown reflecting the weakness of centrally planned economies as well. By mid-1970s, America and its allies were looking to regroup through rapprochement with China after the collapse of the Sino-Soviet ties and through détente with the communist bloc. The politico-economic crisis of the 1970s persuaded advanced Western economies to abandon the post-war policies of even development and the US's role as the manager of the global economy. The way forward, according to them, was to move away from state-induced welfare and regulation towards an open economic system. This coincided with the rise of the right-wing parties both in the US and the UK, where Republicans and Conservatives took on power from the late 1970s onwards, ushering in a new roadmap of economic recovery based on neo-liberal economics. Under this new economic policy, many state-owned assets were privatized as deregulation of markets continued. The primary victims of this politico-economic change were the trade unions. Besides, there was a reduction in welfare programs as well. The beneficiaries were the corporations which received generous tax cuts. The economic strategy as conceived after the Second World War was altered significantly and was fast-tracked in the 1980s towards a more open and liberal world economic system, replacing the state-centric and the even-development approach. This unilateral shift by the US helped them regain competitiveness to a degree, but it did not reverse the damage done as the economic landscape had become more competitive.[xvii]

Transitioning Paradigms: The Developing World's Shift from State-Led Development to the Washington Consensus

When the postwar settlement was underway, many of the countries in the developing world were still under European imperial control and hence were not made part of the decision-making process. Indeed, it was not even a pressing issue for those responsible. Nonetheless, the structural factors allowed for developmental strategies to be incorporated and in some regions like East Asia and parts of Africa and Latin America, it led to success stories. As discussed previously, high growth rates in Brazil, India, Mexico, and Egypt during the 1950s and 1960s suggested that domestic industrial growth through protectionist policies such as tariffs was successful. Therefore, others emulated the model. But after the initial rise in growth levels, many countries in the developing world were unable to wean their economies off the state support system which had allowed them to grow in the first place. Lacking incentive to become more competitive and efficient, domestic industries were unable to compete globally and as is expected, growth rates began to collapse. The prominent exceptions were the Asian tiger economies (East Asian countries) that were able to successfully transition from ISI towards an export-led growth. Their success in the 1970s was a serious blow to the proponents of ISI and led to the decline of such developmental strategies.

For the rest of the Third World, poverty remained a key issue for the developing nations with little signs of declining. The path to development was rather slow and frustrating along with lower growth rates. The perpetual economic recession of the 1970s led to many in the Global South to call for an overhauling of the economic system globally. This demand for economic change upfront became known as the New International Economic Order. The movement was joined by leaders and intellectuals from the Global South who were critical of the existing economic practices that were perceived to be unfair as well as a continuation of imperial policies.

Despite the vocal opposition and formal demand for economic reforms, things began to deteriorate further.[xviii] The undesirable change in fortune for many countries in the South pushed them towards adopting economic liberalization policies.

The Oil crisis of 1973 and the resulting economic slowdown led to a sharp rise in interest rates which, in effect, had a negative impact on most of the Third World states which were inevitably weak to hold off economic shocks. Given their inherent weaknesses, lack of demand for their goods in the international markets, and rising oil prices, many developing states were in dire need of external financial support. The Global South was faced with limited options to help them overcome their economic woes; the available help was in the form of IMF and WB, foreign governments, or loans from international banks.

There were two types of debts. One was the official debt, money borrowed from the IMF and WB by the African states in response to the oil crisis and end of the long boom. The other and more problematic debt was the private debt which was money borrowed primarily by Latin American states from foreign banks and was significant in nature. Interestingly, the 1982 Latin American debt crisis was not a direct result of the oil crisis or the end of the economic boom.[xix] Moreover, the practice of taking private debt was not new and existed before the oil crisis, since the early 1960s when the interest rates were low as compared to the rates during the 1970s when they skyrocketed.[xx] This resulted in banks lending more money to the debtors to pay off the creditors; in short, states borrowed to repay their debts leading to a vicious cycle.

The restructuring process that began with Nixon and continued with Reagan allowed the US to regain its global competitiveness. Some countries like South Korea, Japan, and Taiwan were successfully able to grind out suitable agreements during this period due to their strong export orientation. They were now in a position to make space in the US market in those sectors which were deemed no longer profitable such as the automobile industry. This allowed them to generate revenues due to their ability to maintain their export markets, helping them avoid the need to borrow on a large scale.[xxi] As for the other countries in the Global South, they had to compete with the US in the international market, particularly the agriculture sector. Despite being committed to free trade, the US continued to give generous subsidies to its agriculture industry owing to domestic pressure from the strong farmer lobby. This made it difficult for agriculture-based economies from the South to make inroads into the US market.

The 1980s saw a convergence on the need to move towards lesser intervention by the state in economic affairs and allow businesses and the market to evolve naturally. As mentioned earlier, this was led by President Reagan in the US and Prime Minister Thatcher in the UK. Simultaneously, the Washington-based international economic organizations, the IMF and the WB also used their bargaining power to push the developing world towards adopting the Washington Consensus, a neoliberal economic program aimed at deregulation and free markets. The term Washington Consensus was coined by John Williamson in 1990 and comprised of ten proposals. Washington Consensus was heavily in favor of open markets undermining the role of the state, in stark contrast to the post-war roadmap. The new economic roadmap advised to maintaining macroeconomic stability, allowing open competition in the domestic economy, removing trade barriers, creating conditions for foreign investment, and selling off state-owned enterprises.[xxii]

Donor agencies like the IMF and the WB also demanded structural reforms from recipient countries in exchange for financial loans. These structural adjustment programs (SAP) came with strings attached such as loan agreements that significantly undermined the welfare role of the state since they favored economic reforms in contrast to social welfare. Such policies which reduced subsidies for basic food items were naturally unacceptable to the masses, invoking frequent protests against the governments that resulted in political instability.

Critics of the Washington Consensus argued that a rather modest move towards free markets may not lead to expected results in all cases, a thought that the IMF and the WB officials now accept. There were a number of issues linked with the market liberalization approach bypassing the state. For example, the empirical evidence that connects free trade with increased levels of economic growth has been questioned by scholars like Dani Rodrik.[xxiii] Rodrik argues that there is no assurance that removing trade barriers will lead to economic prosperity. Looking back, the rise of the East Asian economies came on the back of a high degree of protectionist policies while promoting selected few export sectors. Similarly, the Western industrial latecomers, Germany and the US, too, had initially adopted a protectionist strategy and had once developed sufficient competitiveness, shifted towards opening up of their respective economies.[xxiv] For the developing world, economic liberalization has not resulted in alleviating poverty. Rather, it has further enhanced inequality and undermined the already weak social welfare system. In their attempt to reform macroeconomic conditions through the SAP and ignoring the social and political cost of such policies, the IMF and the WB have undermined their own objectives of economic development.

The emergence of the Washington Consensus needs to be understood in the context of the prevailing economic and political developments that were complex to say the least, leading to the end of the initial long boom. It was indeed a counter revolution in the development context.[xxv] Those in the Third World, who were negatively affected due to the Washington Consensus had to bear a significant loss of economic and political autonomy. However, it can also be asked if this has been more of a rhetoric than reality given the troubles faced by the IMF and the WB in ensuring compliance of their programs.[xxvi]

The Lost Decades: A Bleak Assessment of Development in the Post-Cold War Era

The 1980s and 1990s are often referred to as the "lost decades" for development, particularly in Africa, signaling the culmination of national development aspirations of the Third World. With the end of the Cold War in 1989, symbolized by the fall of the Berlin Wall, Africa found itself entangled in civil wars that undermined the potential benefits of economic liberalization. Challenges extended beyond mere economic struggles, encompassing issues such as famine, banditry, health crises, and persistent political instability. Latin America, grappling with recurring debt crises, faced the additional burden of escalating poverty due to rapid urbanization, mirroring the dire conditions in rural areas. Economic backwardness persisted in the Middle East and North Africa. While South and East Asia showcased progress, largely propelled by populous states like India and China, the outlook for other regions remained bleak. Inequality soared both between and within countries.

In stark contrast, the United States emerged in the 1980s as a global powerhouse, wielding economic and political influence. This dominance manifested in escalating military spending, mastery over cutting-edge technologies, and financial prowess in rapidly integrated financial markets. The US's victory over the Soviet Union that culminated in the latter’s collapse in 1991, marked a significant geopolitical shift. The entire communist bloc, including China, shifted towards the free-market system, relinquishing centrally planned economic models. In this transformative period, American economic foreign policy not only shaped but also tailored Third World development strategies to align with its national interests. Regrettably, this influence left the developing world grappling with economic underdevelopment and diminished national autonomy.

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