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## The indebtedness of developing countries

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important to make the most of any time lag between price rises and wage advances. The Government seems to take a philosophical view of the reported spending spree of British consumers (and Continental visitors). Its immediate effect of softening the seasonal decline in business activity is indeed welcome, and insofar as future consumer demand is skimmed off, it may, especially if the predicted "hard" budget reduces private spending power, well result in a drying-up of home demand just when manufacturers have laid the foundations for an export expansion. Wages are in this context less important than middle class earnings, a fact which partly explains why the Government is willing to see low wages go up by as much as 14 shillings a week in the year ending in July 1969 but has set its face against similar percentage increases on the ground of differential for higher-paid workers.

With the time factor so important, the next few months will be crucial for the success or failure of the British incomes policy. If production can be made to rise before the cost of devaluation is felt at the retail price level, there will be the less need to insist on release of home market resources for export. If the import bill can be cut as the result of a contraction in British consumer spending, export gains will have a more pronounced effect on the balance of payments. The Government may therefore be expected to take a lenient view of wage increases yielding gains in production and to be reluctant to

intervene against wage increases if such action threatens to disrupt production. The very importance of exports may thus lead to higher wages in fields of production and transport linked to the export trade, and if exports increase at the same time, the Government is likely to leave well alone.

#### **Incomes Policy at the Price of Political Unpopularity**

Whether the British inflation has been of the cost-push or demand-pull type is a moot point. Successive Governments have tried to fight it on both fronts but laid more stress on containing demand, chiefly because the occasional and rather haphazard attacks on the wage spiral were politically injurious. British Ministers now speak of an export-led boom, partly in the hope, one suspects, that success in exports will help them to avoid having to tackle themselves immoderate and harmful wage demands by those in a strong bargaining position. Not only the Trade Union Council but the Prices and Incomes Board have been brought in to pronounce on what should be Government decisions. The Government, and especially the Minister of Labour, have still to prove that they are determined to enforce their own incomes policy at the price of political unpopularity. They have under existing law the power to delay wage increases for six months even if agreed to by the employers but still hesitate to use, and even more to augment, this legal power.

### **CAPITAL AID**

## **The Indebtedness of Developing Countries**

by Dr Ulrich Jeromin, Hamburg

**I**n the discussion about development aid increasing attention is being paid to the problem of the growing indebtedness of the developing countries and to the question of whether and if so, in what circumstances, these countries will be able to fulfil the obligations they have undertaken regarding repayment. In this regard it is possible to hold widely differing views and to be either optimistic or pessimistic about the possibility of solving the problem. Apart from these two alternatives there exists yet another variant—a point of view which makes light of the problem or even denies its very existence.<sup>1</sup>

Those who incline to this third view, far from casting doubts on the correctness of the available statistics, make them the very basis of the argument. As long as capital aid takes for the most part the form of credits no one need be, or in fact is, surprised that

developing countries accumulate debts. It is undoubtedly not the accumulation of debts in itself that causes disquiet in both creditor and debtor countries, but the debt service that results from it. These payments constitute an additional burden on the already precarious foreign exchange situation and in turn increase still further the credit requirements of the capital-importing countries.

#### **A Development without Risk?**

Such a development, it is pointed out by those adhering to the above-mentioned third view, involves no risk as long as the industrial countries are prepared to grant net capital aid sufficient to ensure a satisfactory growth. This assumes that it will be possible for the creditor countries to go on exporting capital on a steadily rising scale so as to cover not only the debtor countries' fresh requirements but also the service on previously incurred debts.

<sup>1</sup> Compare: Hans-Jürgen Petersen: Verschuldung der Entwicklungsländer (Indebtedness of the Developing Countries). In: Konjunkturpolitik, 12th year (1966), No. 4, pages 223 and following.

Looked at in this light the problem of the developing countries' indebtedness appears indeed trivial. But—one must ask oneself—what is this statement intended to prove? It means after all no more than that a debtor is able to live quite comfortably provided a creditor constantly grants him fresh credits and does not take it into his head to ask for his money back. In such a case the extent of the indebtedness is indeed no problem; the accumulation of debts is no more than a mere matter of form, a matter which, if it should be thought inconvenient, could be disposed of by the simple means of waiving all claims to repayment, not only *de facto* but also *de jure*. However, the assumption underlying this attitude, namely that capital aid is to be granted in ever greater measure, becomes rather unrealistic if strained budgetary conditions make it increasingly difficult to find the necessary wherewithal for the financing of further aid. This is obviously the case at present in most industrial states. And yet Western development aid is, consciously or unconsciously, based on this attitude.

### Outward Looking Industrialisation

The flaw in this reasoning stems from a wrong assessment of the development aim. It is very easy to work out macro-economically the net capital the developing countries require from the industrial countries to achieve a desired rate of growth in their national product. That is however a very schematic and in the final analysis somewhat dubious aim. The industrial countries realise that the massive capital aid they have provided in the past has failed to enable the developing countries to achieve satisfactory growth, and the feeling that they cannot go on as before is at the bottom of the spreading misgivings about development aid in its present form. These misgivings are most strongly expressed by P. T. Bauer, who on the grounds of the experiences made hitherto roundly rejects all development aid.<sup>2</sup>

In so doing this critic goes to the opposite extreme, which, however understandable from the tactical point of view, is certainly not right. Development aid is necessary. But instead of turning the developing countries into permanent dependents of the industrial countries, which is what the present practice amounts to, it would be preferable seriously to tackle here and now the problem of how they can be made to accomplish as much as possible themselves. The necessary capital aid could be on a smaller scale and would thus undoubtedly correspond more closely to the real capabilities of the industrial countries.

The initial impetus can only come from increased exports. It is only by way of increased exports and the resulting rise in foreign exchange earnings that developing countries are put in a position to meet their obligations to provide service on capital. The argument can also be presented in another form: It

is only because the developing countries lack the power to export that they must have capital from abroad. If exports rose capital aid could be reduced. This is precisely what is regarded as essential in the Prebisch-Report, which demands for the developing countries in future an "outward looking industrialisation", whereas hitherto the as a rule rather expensive "inward looking industrialisation" has been the order of the day. Industrialisation in this context means not only the creation of manufacturing industries; it can very well consist in a further development in the output of raw materials, which is still capable of expansion, provided it is sufficiently diversified, that is to say sufficiently adapted to its market outlets.

### Export Aid

This is, however, a much more difficult task to perform than the creation of factories for the production of goods for home consumption. If hitherto development policy has laid the emphasis on "inward looking industrialisation", it is certainly not because the importance of exports has been underestimated. To maintain one's position in the highly specialised markets of the industrial countries requires a technical and organisational standard which developing countries simply do not reach. If they had reached such a level, they would have ceased to be developing countries and would no longer require help from abroad.

In the circumstances therefore no successful effort in the field of exports may be expected from the developing countries themselves. Initiatives in this direction must come first and foremost from the industrial countries. Initiatives of this kind must contain two elements: one is the reduction of existing trade barriers on processed raw materials. A pointer

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<sup>2</sup> Compare P. T. Bauer: Foreign Aid. An Instrument of Progress? In: Barbara Ward/P. T. Bauer: Two Views on Aid to Developing Countries; London 1966

in the right direction was the demand made at the World Trade Conference that developing countries should be granted unilateral preferences.

Preferences by themselves should however hardly be sufficient. It has to be borne in mind that an essential characteristic of a developing country is its lack of adaptability in regard to both output and supply, i.e. its feeble ability to recognise marketing chances and to exploit them. For this reason it must be helped by initiatives on the part of the importing countries—that is the industrial states—which must undertake specifically directed investments and must help the developing country concerned in the marketing of its goods.

### **Indebtedness as a Structural Problem**

Obviously, no such simple rules apply, however, to international trade. Even a present can become unpopular if it exceeds a certain size and endangers the position of home producers in their traditional markets. No country is better placed to know this than Germany, which with its reparations payments after the first world war faced the same problems. These deliveries on reparations account did not break down because of any inability on the part of the German economy to deliver the goods; they were made impossible by the creditor countries themselves, which shielded their national economies against German imports in order to protect their own industries.

The lack of ability on the part of the developing countries to repay their debts is therefore primarily a structural problem. In the industrial countries traditional exports of developing countries are constantly replaced by synthetic products while, on the other hand, spheres of production which might very well be transferred to less developed national economies are being shielded from foreign competition. A foremost example of this is the cotton industry whose rapid expansion in the developing countries has been stopped by restrictions on imports into the industrial countries. The same applies, however, also to other products extending even to technical products such as bicycles and sewing machine from India.<sup>3</sup>

Structural adjustments cannot be avoided. The difficulty is that such processes of adaptation are usually not without friction and bring in their wake partial imbalances of fairly long duration, which can be very painful to those directly affected. Structural adjustments mean competition and pressure on prices, but they also mean dumping through lower wages, for the developing countries can force an entry to the world market only through depressing their wage costs, and not through the application of more advanced technology. Japan has gone this way; it is today being followed by a still steadily increasing number of countries such as Hongkong, Taiwan, South

Korea and India to mention only the most important ones. Wage dumping is however still regarded as a sufficient justification for almost every conceivable kind of state interference in the international trade. This reaction to wage dumping still prevails today although the conditions which produced it—that is to say the unemployment that prevailed between the two world wars—no longer exist and have even been reversed. In the long run it always pays a country to purchase the goods it requires as cheaply as possible. Nevertheless it still seems to be inconceivable that a government should facilitate imports of other than raw materials from countries with a low income level.

### **Return to Bilateralism**

However, in adopting such an attitude the industrial countries give up their chance of getting part of their claims repaid without trouble. Their policy, too, becomes involved in a certain contradiction. On the one hand, in granting amortisable and interest-bearing credits they expect the loan capital to flow back to them, on the other, they make difficulties in accepting delivery of goods from the debtor countries—the only way these countries have of making that reflux possible. Such a policy must inevitably lead to an accumulation of debts in the developing countries.

In these circumstances a return to bilateral trading would surely bring certain advantages because bilateralism would show more clearly the obligation of the creditor states to accept delivery of goods from their debtors. As far as debt-settlements are concerned the Eastern bloc with its barter agreements has therefore the advantage over us, and these barter agreements seem to be the feature which proves most attractive to developing countries. As far as the Western world is concerned, the bilateralist character of such agreements is enough to condemn them out of hand.

One way out of the impasse is at present being explored. It is a relaxation in the credit conditions. This entails formal renunciation of part of the repayment as described above and as such without doubt a certain alleviation in the debt burden. On the other hand, it leads to no fundamental change in the present situation, above all it does not relieve the donor countries of their obligations to help.

It remains to examine the question whether in the end it would not be cheaper for the industrial countries to devote part of their development aid to a planned and smooth structural adjustment, that is to say to use it to finance the abandonment of certain branches of production in favour of imports from developing countries and in this way to effect systematically what one is unwilling to leave to the ordinary marketing processes. In any event, this way of utilising the available funds would prove in the long run more productive.

<sup>3</sup> Compare: Towards a New Trade Policy for Development. Report by the Secretary-General of the United Nations Conference on Trade and Development, New York 1964, page 24.