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Reduction of Deficits of Payments

by Professor Emil K  ng, St. Gallen

The competent international agencies have been seriously discussing, in recent years, whether it ought to be suggested to the wealthy industrialised countries of the world that they must take over, on their own account, the balancing-out of developing countries' deficits of payments. Cynics may well emphasise that this is not a new idea, since this is being done all the time. They are right in so far as most developing countries could not afford such large imports as they do receive unless governments of the "rich" Northern hemisphere were always prepared to foot the bill by capital grants-in-aid and credits. It is said that the deficits of the "poor countries" could not possibly grow further than the influx of foreign currency to their treasuries permits.

Innocently Acquired Deficits

Undoubtedly, the said objection is justified in part, as developing countries are, in fact, purchasing import goods usually to the limit of their supplies of internationally convertible currency. However, in the context in which such proposals are being examined here, an appreciably different aspect of the problem will be in the foreground of the discussion, for it is intended to plan the proposed currency injections deliberately, so that they will indeed provide genuine support to the respective balances of payments, instead of being swallowed up under the title of generalised assistance. Moreover, nobody intends to pay for any old deficit but only to bridge those gaps in the balance of payments which have accumulated through factors beyond the control of the debtor government, as it were, "innocently". In the main, it is suggested that the prices of most commodities exported by developing countries may suffer from violent price deterioration in world markets, which producers can do nothing to avert, though these do serious harm to their economic development programmes on the financial side.

Yet a more detailed examination will soon make it clear that deficits in their balances of payments which have not been caused by the acts or omissions of affected countries are not all caused exclusively by price fluctuations in the world's mar-

kets. It will therefore be necessary to widen the scope of our scrutiny and to examine each individual case on its merits, as to whether a given deficit has been culpably caused by the debtor or not. For there are, and have been, actual cases of price decay in world markets which were caused by the misguided actions of the suppliers. They may have, for example, boosted their production in an exaggerated fashion, without regard to the absorptive capacities of market outlets.

Judging such behaviour from the point of view of criminal law, however, involves also extremely delicate problems of limitation of guilt. How is one to deal with the effects of political instability in any given country which may prompt investors to engage in wholesale capital flight or in regular transfers of trading profits to safe accounts abroad? What about the harm done through too rapid industrialisation, which—perhaps for reasons of national pride and prestige—insists on setting up national steelworks and automotive plants, national airlines, or even the manufacture of airframes and complete aircraft? Is any supra-national agency competent to pass moral judgment on such events? What is one to do after nationalisation of foreign companies, which may cut off the import of foreign risk capital, so that the nationalising government's balance of payments becomes severely lopsided? One of the most frequent cases in point will, naturally, be that of inflationary credit and public sector spending policies which destroy the competitive strength of a country's exports and thus reduce its currency income from selling abroad. It is not possible thus to plan deliberately for a deficit in any country's balance of payments, if that country's government can be sure that industrialised countries will always come to the rescue and close the gap? Take again the population explosion frequently met with in developing countries: has the resulting need for imported foodstuffs been brought about deliberately or without design, in the sense that the responsible government ought to have taken steps for mitigating or warding off this "explosion"? Has an import surplus been caused by insufficient local farm output?

There is no end to the list of possible causes of a deficit on international payments account. But even our sketchy enumeration of them highlights the difficulty of distinguishing between deficits that have, and that have not, been caused by deliberate action or omission, and to grant support only to those not being brought about culpably. Moreover, and more importantly, proposals to help in this fashion are essentially ones that are restricted to stopgap measures, which violate a fundamental principle—that of truly effective aid, whether this is extended to one's own paupers or to impoverished developing countries. No matter how poverty has been caused—there is no difference in pauperism's effects, and stopgap alms will never effect cure.

Industrial countries behave like a rich uncle who underwrites his prodigal nephew's debts, no matter how much they may grow, and how they are caused. It is obvious that such a blank cheque guarantee must demoralise the subsidised nephew. Price guarantees and guaranteed market outlets—which Europe's and North America's farming communities enjoy—have a similar effect: the recipient of such aid does not need to make an effort himself. Self-help becomes superfluous, and any attempt to cure the malady through self-discipline will remain unrewarded — on the contrary, it will be penalised through the withdrawal or reduction of foreign gifts.

Structural Conservatism

Under the assumption that help would be given only in cases of a commodity price slump which reduces currency incomes of developing countries, this being done, the impoverished producers towards whom such aid is aimed are receiving a disincentive for not changing their production methods and/or facilities, so as to meet effective demand. Quite independently of the question whether they produce things of which there is already a glut, they will be given financial support for bridging the gap between their reduced sales income and what is thought to be a "fair" income level. Their interest in changing their traditional ways will thereby be swiftly reduced to nil — in the same way as it happens with farmers when the government guarantees their sales. In either case, it will, however, soon become imperative to launch further expensive measures — which are known as "utilisation campaigns". Those who are made to pay for all this have then to pay twice over — once through their subsidies which are used to bridge the gaps in the balance of payments, and the second time for making the subsidised products artificially cheaper, so that they need not be burned or dumped into the sea

but may find buyers. But all this conserves the underlying causes of an unsatisfactory situation, and there is no reason for ever ceasing to pay out the double subsidies.

And then there are even cases of declining export earnings which have little or nothing to do with world market price fluctuations but with the fact that the products supplied are not of the required quality. This is rarely the case with metals or other industrial raw materials but frequently with the produce of farming and cattle raising, as well as with semi-finished and finished industrial products. One of the major causes for East Europe repeatedly being frustrated in trying to do business with the West is just this shortcoming. Should they also be regaled with support payments for overcoming the balance of payments difficulties? Similar conditions are caused by technological advances in synthesising materials capable of replacing naturally grown or extracted commodities for a number of uses, whilst the prices of such synthetics may be much more stable than those of their natural competitors, and their physical properties more reliable and/or superior to those of the natural product. Both then induce users to prefer them to the natural raw materials. If this is the case, it would evidently be crazy to keep inferior production in developing countries artificially alive by subsidising it, thus causing stocks to accumulate which could never be sold.

Vagaries of Demand

There has been occasion repeatedly to draw attention to the parallelism between the problems encountered by the farm support policies of industrialised countries and the measures advocated and practised for financing developing countries' deficits on international payments account. This similarity goes further, when we subject the conditions which determine demand to closer examination. It is well known that demand for food is relatively inelastic, which means that it grows only moderately after the available real income of the consumers expands. There are even cases in which marketable quantities will contract with a rise in income—e.g. of potatoes, milk, or bread—unless a rise in population makes up for this. Complete similarity is shown by the markets for most bulk commodities which are supplied by developing countries — the elasticity relation between demand and income development is low or even negative there.

In cases which show this feature, it is extremely difficult to produce valid advice, both in the national and especially so in the international field. Within the confines of a single national

economy, there may be a certain chance to help national producers by shielding them against the impact of foreign imports. On the other hand, protectionism as a form of aiding national producers will increase the difficulties encountered by producers in developing areas much more. But who would have the temerity to prevent national governments from taking care of their own nationals first, and of others only in the second instance? Should governments neglect this duty, the notorious revolts and risings of the farming populations would become even more frequent than they are. All this makes it obvious that it is extremely difficult to help producers of commodities effectively who are faced by long-term changes in demand structure that tend to their disadvantage.

Problems of Statistical Techniques

It appears also generally to be not a very useful approach to take a highly complex variable—like a deficit in a given country's balance of payments—as the basis for requiring industrialised countries to shoulder the apparent inequality between income and outgoings, because this gap is

caused by a great variety of individual factors, of which a price slump in foreign markets may be only one. Capital flight may be, for example, the prime or a major contributory factor, but it has certainly nothing to do with low prices. Another possible adverse influence may be artificially boosted imports. Those who are really determined to make financial grants exclusively in respect of price deterioration must never be guided by balance of payments developments alone, but they cannot avoid studying individual export products separately.

Seen thus, the problem at hand might be tackled by calculating past price trends for every single export commodity and by projecting such trends into the future by extrapolation. Should actual market prices remain below this calculated level, support and equalisation payments might be granted, and their size would be related to the differential which can be worked out with comparative ease. It will be less easy, however, to trace a trend curve which meets all possible requirements, for who will fix the length of time over which past data must be available, and that of the future to be projected? Even the most

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ZOLLPRÄFERENZEN FÜR ENTWICKLUNGSLÄNDER

(Tariff Preferences for Developing Countries)

by Ernst Niemeier

The traditional export of raw materials involves but small growth chances still for the developing countries. But does the industrial nations' preferential treatment of industrial export products lead to an increased integration of the industrially less developed countries? This study shows by a juxtaposition of quantified static and dynamic effects of tariff preferences that the dynamic efficiency gains over-compensate by far the negative static effects of preferences.

Octavo, 250 pages, 1970, price DM 34.—

V E R L A G W E L T A R C H I V G M B H - H A M B U R G

highly skilled statisticians would have a field-day of professional quarrelling ad infinitum on this subject: should the price curve follow linear projection or a more complicated relationship? There are no generally accepted principles or guidelines for solving such conundrums. Only one thing will be certain: all the potential beneficiaries will be interested in the calculated differential being as big as possible. They will therefore try to achieve what they desire by launching highly technical debates on statistics.

The Beneficiaries

Talking of a differential between effective market prices and "target prices", this raises very similar problems as does the principle used in a national economy which grants prices "to cover the costs" of its own farming community — with all their shortcomings. At the same time, this suggests the rule that only producers who operate at a deficit may receive support. This again would lead us far astray from the original proposal to fill the gaps in the balance of payments. If only individual producers are to be subsidised, there would be no need to use for the purpose other than their national currencies. If a balance of payments is to be brought into equilibrium, on the other hand, only the supply of international convertible currencies will do.

As a matter of fact, such currency flow would be claimed by the government (or its central bank) of the country to be so aided, and the government or its agency would strenuously oppose any attempt of foreign governments or international organisations to pay out a direct dole to hundreds of thousands or even millions of local nationals. But once a national bureaucracy gets hold of monies intended as subsidies, the risk of corruption is rife. There is no guarantee that any support payments or equivalent aid in kind will ever reach the persons in need of them. Effective control of subsidy uses is virtually impossible. Such projects would be contaminated by the same maladies which show their ugly head again and again when entire national development programmes are to be financed: the funds are drained away into the pockets of greedy and poorly paid civil servants.

Grants-in-Aid or Loans

It is self-understood that potential beneficiaries will always plead for outright gifts in preference to credits. On the other hand, the point of view is completely valid that credits, by being based on the repayment principle are a necessary discipline and would therefore be more adequate for the purpose. Incidentally, it is a fact that commodity prices do not by any means always hover below

the calculated or established trends. If the calculated trend curve is correctly traced, it will be found that actual prices are in virtually as many cases situated above as below the trend level — which under principles of elementary justices ought to oblige the beneficiaries of prices "above the line" to cede a part of their uncommonly high sales revenues. This would make the system symmetrical, whilst most present systems are asymmetrical. Basically, the prices received by producers would thus hug the trend curve closely. Soaring world market prices would not cause them to expand production capacity too much, which must lead to price decay later.

Under such conditions, the entire project might be conceived as a kind of equalisation fund, for which only initial capital aid would have to be produced by the industrialised countries. As soon as world market prices remain below the target level for any length of time, this would absorb the initial capital, but it would be replenished through fluctuations in the opposite direction. The system would thus become similar to those international commodity agreements which were set up to reduce the amplitudes of price fluctuations over longer periods. It is known that such solutions have much to be said in their favour, but in spite of this, only a very limited number of them is currently operating, and they have not always proved their value as soon as producers' interests prevailed.

An Immature and Unconsidered Project

So far, our discussions of the pros and cons of the measures proposed will leave the reader with the impression that the suggestion to finance the poor countries' balance of payments deficits from the coffers of the rich ones represents an immature idea, which has not yet been sufficiently considered in all its aspects. It must even be termed surprising to a high degree that it has been brought forward at all in the described form, as a serious contribution. People who have some deeper knowledge of the usual methods of national farm support policies ought to be frightened, from the very beginning, of applying similar nostrums to international problems. All the results of these support policies have so far been liable to discredit them. It seems that people do not wish to see the similarity between national economic failure and international fallacy, or else they are determined to ignore it.

Closer examination of the project has resulted in the discovery that it would be virtually only harmful. True, successful development aid, in itself, is anything but a simple proposition. Yet there are measures available whose success ratio, in rela-

tion to the funds used, is incomparably higher, and it is precisely these which merit to be considered in the first instance. If we wish to salvage at least something from the notions which were discussed here, we will need to reshape them from top to bottom. It will be necessary to prevent funds from being poured away into a bottomless barrel, and genuine self-aid will be needed to be

set in motion. It is useless to preserve a given structure — adaptation to the changing conditions of world markets is what is required. It is therefore preferable to give credits instead of making gifts, because this will ultimately result in the setting-up of something akin to a price stabilisation fund. But this is vastly different from what was intended at the beginning.

Import Substitution and Industrialisation

by Maurice Scott, Oxford *

For many developing countries that have wished to industrialise, it has seemed best to do this by starting to produce for themselves manufactures which would otherwise be imported. This has been achieved by restricting imports by a variety of means: tariffs, multiple exchange rates, import quotas or outright prohibitions. At a single stroke, these measures provide an assured market for the new industries, make them highly profitable and so attractive to both domestic and foreign capital, and, by reducing imports of the finished goods, provide the foreign exchange necessary to pay for required imports of machinery and materials. Furthermore, as the new industries grow, some of their high profits will be ploughed back into further investments, thus ensuring continuation of the process. All this is achieved, apparently, at no cost to the government. It is hardly surprising, then, that countries wishing to industrialise have sought to do so through protection.

Disenchanted Consumers

Nevertheless, as time has passed, disenchantment has set in. The first stage of import substitution involves the replacement of imports of manufactured consumer goods by home production. Apart from some consumer durables (notably motor cars), economies of scale are not very important here, and it is possible to produce clothing, leather goods, manufactured foodstuffs,

toys, cigarettes, matches, soft drinks, beer, etc., in factories of a reasonably economical size for the home market in quite a number of developing countries. In any case, it is the consumer who suffers from higher prices and poorer quality, and one can appeal to his patriotic sense to persuade him to suffer in silence. Once these industries have been set up, however, a whole new range of imports has been created, consisting of the semi-finished manufactures and materials required to supply them, as well as the machinery needed for replacements and further extensions. As home production moves into these fields (and also as it moves into the remainder of the consumer goods field) more cases arise where economies of scale are very important (motor cars, chemicals, basic metals). Furthermore, the users of these products are other producers, who do not wish to be compelled to buy from high-cost domestic sources, especially if quality is poor and delivery uncertain. Import substitution thus begins to look increasingly difficult.

Effect on Income Distribution and Employment

Another aspect of the policy which leads to increasing dissatisfaction is the effect on income distribution and employment. The high profits of domestic manufacturers permit them to pay wages which are often two, three or four times as much in real terms as workers can earn in the countryside. Governments have sometimes encouraged the payment of high wages through minimum wage legislation, support for trade unions, or other legislation protecting urban workers. This has had two effects. First, it has encouraged an influx of job-seekers from the countryside to the

* Mr Scott is a staff member of Nuffield College, Oxford. This article is based on a comparative study of industry and trade in some developing countries undertaken by the author in collaboration with I. M. D. Little and T. Scitovsky at the Development Centre of the OECD in Paris. The study, together with companion volumes dealing with particular countries by other authors, will be published by the Oxford University Press for the OECD in the Spring of 1970. The remarks made here do not necessarily reflect the views of the other authors or of the OECD.