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Changes in Capital Aid

The foreign indebtedness of developing countries is becoming more and more of a problem. To what extent is capital aid given by industrialised countries in need of reform? And what measures must the Third World countries take in order to overcome the problems of foreign indebtedness? We spoke with Dr Wilhelm Hanemann from the Federal Ministry of Economics about these questions.

Dr Hanemann, the extent of foreign indebtedness in developing countries is alarming. In 1968 it reached \$ 53.4 bn, with interest charges running \$ 4.7 bn. To what will this trend lead?

The indebtedness of the LDCs is indeed a problem to which we must earnestly devote ourselves. You have certainly heard that the World Bank declared, during their last annual meeting in Copenhagen, that a special study group would be formed to concentrate on this problem. I believe it to be very important and beneficial that an institution, endowed with such knowledge and capabilities as the World Bank is, will undertake the methodical study of this question. The global figures however

can be misleading. In a great number of the relative countries, the amount of foreign indebtedness is insignificant. Their export income is burdened only to a small percentage with payments on earlier loans.

But are not these countries exceptions to the rule?

Naturally there are developing countries whose repayments make up more than 20 p.c. of their export income. But here also, the percentage of loan payments must not deceive. An indebtedness ratio of 3 p.c.—5 p.c. can mean a great deal to a country that must overcome difficult economic conditions by falling back on only meager reserves. On the other hand, a

higher rate of indebtedness need not be threatening when the particular country has reached the so-called take-off phase and, because of healthy economic policies and its own resources, is in a position to further develop its economy. It is certain that some of the countries undergoing this development process are so advanced that it is no longer necessary for them to take up such large loans as in the last ten years, the first Development Decade.

Reduction of Federal Republic's Contribution

German public aid decreased in 1970 from DM 2.33 bn in 1969 to DM 2.24 bn. Is this retrogression the first sign that such a

high rate of indebtedness is no longer necessary for the LDCs?

I would not see it like that but would attribute this development to other origins. The Federal Government accords foreign aid great importance and has set the goal for foreign development aid expenditures at 1 p.c. of the GNP. That the official funds should amount to 0.7 p.c. of the GNP is still one of the aims of our policy. Hitherto the 1 p.c. goal was always achieved. That aid in the past year fell below the 1 p.c. goal can be attributed to several things. On the one hand the GNP showed a very high nominal growth of 12.4 p.c., and on the other hand fluctuations, that could not easily be influenced on short notice, appeared in the development aid payments. One should not place too much value on the 1970 results, i.e. 0.79 p.c. of the GNP. Our guide for the future remains at 1 p.c. of the GNP.

Insufficient Planning?

The indication of a quickly growing GNP does not change the fact that not only the public but also the private contributions actually decreased. Would it be justified to say that the financial aid for 1970 was not sufficiently planned?

I would not see it like that. The problem of relatively protracted aid payments appears time and again in all donor countries and international institutions. I think it would be biased to see a negative element alone in the fact that a delay occurred.

What payments were delayed in one year are not lost to the LDCs but simply postponed.

Money Market Tighter

Does that mean that the decrease in official payments in 1970 will lead automatically to a significant increase in 1971?

I would not designate that an inevitable development, but in principle it is intimated in that the goal is 1 p.c. Since the government gives special priority to development aid, it is certainly to be assumed that in the future public contribution will increase.

High Interest Rates

On the German market the smaller number of security issues for the benefit of the developing countries significantly affected the decrease in private contributions. Is this a tendency that will continue?

You have just broached a very interesting subject. In 1968 and 1969, when our capital market was able to offer very large issues, we knowingly opened the doors of the German capital market wide to international organisations, such as the World Bank and the regional banks. The outcome was that in these two years, middle- and long-term financing of the World Bank was carried to a great degree by issues in the Federal Republic of Germany. The World Bank welcomed this development particularly because at that time no funds were available from the American market. The situation

in the FRG has naturally altered since that time. That does not mean however that today the doors are closed to the German capital market, but financing cannot be accomplished in the same magnitude as in the mentioned years.

IDA and World Bank

Does it not hold true that the World Bank has avoided the German capital market because of the high interest rates?

The World Bank placed loans in the German capital market also last year, a time in which the interest rates were above the present level. But naturally in its activities the World Bank has to contemplate at which rate of interest it places loans and at which rate it lends out. Since the borrowers are developing countries, the World Bank tends to be generally more cautious in a time of very high interest rates. Thereby one must not forget that the International Development Agency exists alongside the World Bank. The IDA is not financed by the capital market but by budgetary contributions from the industrial countries. Developing nations, who due to their financial situation are

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not able to pay market determined rates of interest, still have the possibility of carrying profitable projects through with the help of the World Bank group. The IDA loans are interest free and guarantee a 30 years' pay-off period.

Lack of Funds

Whereby one is reminded of the fact that for this reason the IDA suffers from a chronic lack of funds.

That is correct. The IDA needs to increase its funds regularly in order to fulfil its purpose. We are now in a third phase of fund supplementation. When negotiations have been concluded by the Parliaments, the yearly flow of funds to the IDA will be much larger than in the past. Here it has also turned out that the donor countries are willing to carry as much as they are able of the cost of the necessities for financing the building up of the LDCs. The Pearson Report pleaded for augmentation of IDA funds to \$1.5 bn by 1975. We have not come quite so far but the aspiration to increase to \$1 bn per year is a significant improvement over the \$400 mn annually available in the past.

Concentration Points in Capital Aid

Within the scope of the new Federal concept of development policy, it will be attempted to draw back from isolated project-related measures and concentrate on program-related ones. To what extent will capital aid be affected?

Capital aid will not be immediately affected but should merely be included even more in the total planning of the LDCs. It must then be considered how development aid can best be employed to aid

these countries in furthering their goals.

The Federal Government does not intend to attempt to force a nation to accept a particular concept but rather to let the LDCs develop their own concepts and then examine how the available funds can most effectively be apportioned for the separate areas, i.e. technology, education, finance, etc.

The Problem of Earmarked Funds

One of the goals of the developing countries is to bring about the discontinuance of the earmarking of funds as soon as possible. What prevents the FRG, an export intensive country, from setting a good example and foregoing such ties?

I think that the Federal Government has already set a good example in the practice of earmarking funds. Germany has always supported the free choice of supply sources. The earmarked portion of our capital aid decreased in 1970 to 26.8 p.c., following 32.8 p.c. in 1969.

At all international meetings we have continually supported unrestricted capital aid, whereby we assume that fair international competition would be secured. Actually the resolution that was passed by the DAC in Tokyo in 1969 can be attributed to our ideas. The Federal Government would welcome the acceptance of the principle of unrestricted capital aid by as many donor countries as possible; major progress in abolishing the system of earmarked funds can only be achieved when the donor countries decide on concerted action based on reciprocity.

Attempts at Diversification

What possibilities are open to help the LDCs take part in the

world-wide exchange of goods and services?

The Federal Government has permitted the LDCs since 1969 to take part in competitive bidding, also with respect to that part of capital aid which was earmarked. The LDCs however did not achieve the hoped-for success, the main reason perhaps being their limited efficiency in the industrial sector. With that comment I have addressed the important problem of diversification. In the long run we will be able to incorporate the LDCs into the world economy only when advances are made in this sector. That is naturally a process that can be brought about only very slowly and from which one cannot expect success too quickly. To a certain extent the industrial countries have always attempted to aid the LDCs in the building up of new production; however decisive advances in diversification will demand a great deal of time.

One may also not forget that those developing countries with a very one-sided export structure have so much experience in this area that comparative advantages are to be realised. These comparative cost advantages could be lost to the same extent that the LDCs would be incorporated into the diversifying process. Therefore we must push the diversification endeavors ahead with caution.

Structural Changes through Diversification

Does not cautious action from both sides set the prerequisite that the industrial countries comply in a greater degree than in years past with the wishes of the LDCs to voluntarily forego production?

In Germany we are open to the process of structure adaptation, and we do not believe in

attempting to artificially retain obsolete structures...

... but we support such obsolete structures with high subsidies ...

... what we do is aiming at supporting the diversification process by an adaptation of production to structural changes. We also try to promote the re-education of workers to give them better chances. We cannot tolerate the sudden collapse of a branch of trade. We lean very definitely toward the fundamental idea of a structural change. I would not say that structural changes should be forced, but the process should be supported and we are trying to do just that.

If the Federal Republic should declare itself the outrider for a new concept of diversification, cannot the suspicion arise that the sinking capital aid is simply being glossed over?

I do not want to assert that we are or want to be the outriders of a particular development. I simply think that diversification is a highly important activity for all countries. And I imagine that it would be very useful if this problem were attributed particular importance in the coming international talks. I do not expect however sudden and spectacular decisions but rather the beginning of the systematic examination of the possibilities of initiating and continuing this process of diversification over the years.

Raw Material Agreements — The Solution?

Does not this process necessarily require complementation through agreements on raw materials?

It cannot be dismissed that in several commodity sectors—nor-

mally fewer than is generally assumed—agreements on raw materials are effected temporarily to guide development in the desired direction. It would certainly be wrong to consider agreements on raw materials the cure-all for the problems of the LDCs.

Does not the attitude of the German Government appear nevertheless somewhat schizophrenic? On the one side agreements on raw materials are supported and on the other such agreements are not undersigned, as for example the case was with the Sugar Agreement.

The conclusion of agreements on raw materials is not a problem that can be generally and dogmatically handled. You are aware that the FRG recently entered into the Tin Agreement. It is thereby clear that from case to case the possibilities of market improvement or adjustment for the future are examined. But I think the idea of agreements on raw materials would be overly strained if it were expected that simply the ratification of an agreement—no matter how it is structured—signifies in every case a step forward.

Tariff Preferences as Aid to Trade

Another possibility for aid in the area of trade exists: concession from the industrial countries of preferences. How do the ideas of the Federal Government appear in this area?

The EEC just recently took a decisive step in this area. It submitted a proposal that, in essence, would do away with tariffs on semi-finished and finished goods from the LDCs under certain ceilings. I think this step is representative of a very important development. It is significant because it opens new marketing opportunities to the LDCs and because it repre-

sents a temporary interruption in the most favoured nation principle. I am convinced that with the tariff preferences a path has been cleared that leads in the right direction.

Funding without Stipulations

These trade measures should generally improve the indebtedness situation of the developing countries. A further possibility lies in funding the debts. What meaning would you attach to such a solution?

By examining the indebtedness of the LDCs one will probably be confronted in the future by similar situations, for which such rescue operations appear to be unavoidable. The Federal Republic will certainly be prepared to sit at the international conference table in such cases. In the past we have also taken part in funding actions and I do not want to exclude the possibility of the Federal Government doing this in the future.

Without making demands on the political good conduct of the concerned countries?

The political conduct of those countries concerned would not be as decisive as their economic activities. When the discharging of a debt is postponed, it means that unexpected burdens must be carried by the donor countries. That may be necessary but it only then has meaning when there is the chance that the situation actually can be improved through appropriate economic policies. We find it important that the International Monetary Fund and the World Bank take part in such international discussions because on the basis of their comprehensive knowledge of the problems they are particularly well-qualified to analyse, criticise and advise.