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# New Ways of Financing LDCs

by Dr Alfons Lemper, Hamburg \*

**The forthcoming third plenary meeting of UNCTAD in Santiago will primarily consider how the less developed countries (LDCs) can be integrated more effectively into the world economic system. To solve the problem of development of the so-called "Third World" it is considered essential to open up new financial resources for the LDCs.**

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Whether one looks for ways of broadening the flow of trade or of tapping fresh sources of finance, the nub of the problem is always the transfer question. Means must be found of making it easier to transfer so-called real resources from the group of industrialised countries to LDCs. By intensifying trade exchanges the LDCs are provided with more leverage to "acquire" through their own efforts genuine foreign exchange assets which in turn contribute to a solution of the transfer problem. In the case of financial transactions (trade credits, bilateral and multilateral funds, direct investments, etc.), it is those who provide the capital that provide the leverage. In the following discussions we propose to leave trade questions aside and to confine ourselves to searching for practical means of achieving transfers in real terms by way of capital infusions.

## **The Problem of Indebtedness**

The extent of financial transactions is limited by two factors. There is first of all the problem of the LDCs' indebtedness and debt services. This problem is extremely serious. According to a report published by the Secretariat of UNCTAD, the external public indebtedness of 80 LDCs during the sixties increased each year on average by 14 p.c., reaching by 1969 the total of \$ 59 bn. In the same decade the amounts required for debt services rose on average by 9 p.c. with the result that in 1970 liabilities on that account are estimated to have amounted to \$ 5.9 bn. The net inflow of financial funds has meanwhile decreased from \$ 5.4 bn in 1965 to \$ 5.2 bn in 1969 with India, Pakistan and a number of particularly backward countries being especially hard hit. The UNCTAD-Secretariat fears that in the seventies the problem of indebtedness will become graver still. These facts show that there is a danger that

the transfer practices such as applied hitherto may turn out to be a blind alley so that the system of giving aid to LDCs may lose its credibility.

Each financial transfer to be successful must lead to an actual transfer of real resources it initiates. In the following it is intended to give a brief outline of the most important alternatives that exist.

## **Export Credits**

The usual trade credits reveal the nature of the problem in a fairly simple form: The customer, be he at home or abroad, is given the possibility of acquiring goods or services without in return being able, or obliged, to offer immediately goods or services of his own. Trade credits thus amount to the granting of a one-sided claim to a transfer of resources. Trade credits therefore have this in common with all other credits that they produce an inflationary impulse. This impulse is all the stronger, the less elastic the supply and the less possibility there is to consolidate the credits by means of voluntary or forced saving.

In actual fact, the importance of export credits granted to LDCs has greatly increased in recent times. The volume of such credits has risen from less than \$ 500 mn at the end of the fifties to more than \$ 2 bn in 1969 with the greater part of this total being covered by state guarantees. Although in absolute terms these trade credits granted to LDCs are not excessive when seen in the light of the immense capital requirements of these countries, they nevertheless aggravate their problem of indebtedness. For it is no secret that export credits are a rather expensive form of financing, for one thing because of the interest they carry, but also because the granting of credits frequently goes hand in hand with higher prices being charged. Moreover, there are limits to the granting of private export credits—state

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guarantees notwithstanding—inherent in the prevailing credit procedure which requires exporting firms to carry part of the risk themselves.

### Transfers of Public Capital

State credits of a bilateral or multilateral nature may be granted direct to certain countries or in the form of contributions to multilateral organisations such as IDA. Being normally budgetary appropriations, they are as a rule tantamount to an equivalent withholding of domestic purchasing power, representing in a way a form of compulsory saving. Thus far the economic basis for a real transfer would seem essentially to be sound, for no inflationary effects need be feared from such a transaction. On the other hand, the question is whether, and if so to what extent, this type of capital transfer may be expected to expand, for industrial countries are notoriously short of public funds and this shortage causes their governments to have recourse to, at times, extensive deficit financing, particularly as it is always difficult in countries under a parliamentary regime to get its nationals to accept heavier tax burdens for purposes of development aid. Quite apart from this, such transfers of public funds also contribute, though to a lesser extent than do export credits, to the LDCs' problems of indebtedness.

The latter applies especially to transfers by way of organisations which finance themselves through loans as for example the World Bank. Nobody will question the World Bank's efficiency, but its credits are extended at the prevailing capital market conditions and command not inconsiderable interest rates. On the other hand, the lending powers of such institutions depend on the (more often than not rather limited) availability of funds on the international capital markets. The real transfer of such credits presents however no problems.

### Direct Investments

A special case are direct investments; they, too, lead ultimately to a transfer of resources. Admittedly, their share in the total of private capital transfers has been falling steadily since the mid-sixties, but even in the period from 1965 to 1969 they still amounted to something like \$ 2.5 bn. There are limits to the opportunities for such transfers of resources by way of direct investments or rather to the readiness to undertake such ventures. One precondition is that investors must be prepared to invest capital in foreign projects which frequently are economically and politically risky. Another is readiness on the part of the host-country to allow foreign companies to operate more or less under their own manage-

ment. All kinds of prejudices militate against such an open-door policy, and at present there are only relatively few countries that make use of this instrument in a purposeful and unbiased manner.

And yet, there can hardly be any serious differences of opinion as to the objective possibilities such direct investments open up. For direct investments are incomparably more effective than loans or credits because they contain at the same time that technical and management know-how of which LDCs are at least as short as they are of capital. It is only fair to add that LDCs whose need is greatest are only relatively rarely among the countries that attract direct investments from industrial nations. The latter's preference is known to be in favour of countries with an already existing sales potential. Nor are direct investments a panacea. Much depends on the kind of technology that is to be imported. Any thoughtless transfer of a highly developed technology may bring about an economic dualism which easily leads to social upheavals.

Viewed solely from the standpoint of the actual transfer of resources, however, direct investments most certainly belong to the least problematical of transfer mechanisms. Their inflationary effect is as great or as little as that of any investments at home. Objectively, this instrument promises considerable success; the responsibility for its use is shared by both groups — developing and industrialised countries alike.

### The "Link"

Finally, there is yet another, new way of transferring capital; it will be in the foreground of the discussions at Santiago. It goes under the name of "link" and implies the coupling of Special Drawing Rights (SDRs) with development aid. It is of course impossible to predict what will emerge from this discussion, but that much can be said already: the industrialised countries, the majority of which have hitherto rejected such a link, will find it hard to marshal effective and convincing arguments against the idea. For in view of their extreme shortage of capital and their immense debt burden the LDCs are simply driven to take the initiative. Moreover, they have much reason to feel that the way in which the SDRs are used at present is unjust and an affront to them.

Objectively speaking, SDRs are nothing but a means of creating international credit in much the same way a bank creates credit in its own country (the term "liquidity" glosses over the true facts of the case and makes them look to some extent more innocuous). True, the credits

created by dint of SDRs are not made dependent on any tests of credit-worthiness, nor are they linked to any cash reserves, nor again are they repayable to the extent of 70 p.c. Leaving aside the insignificant interest rate of 1.5 p.c., they really constitute purchasing power given away free: "Manna from Heaven".

### Claims on Resources

The creators of SDRs like to minimise the role of these SDRs as purchasing power. For them they are primarily "reserves to hold". The distinction between "reserves to hold" and "reserves to spend" is however comparable to a distinction between "cars for the garage" and "cars for driving". In reality, SDRs constitute claims on the resources of other countries. Credits are created with the intention that they be used at one time or another. If they are drawn upon, however, they become demands on the resources of other countries, and that, in the case of SDRs, for next to nothing.

It is this aspect that gives rise to criticism of the way SDRs are being distributed. The key according to which SDRs are at present distributed is modelled on the quota system of the IMF. Under that system 72 p.c. of the SDRs are allocated to industrialised countries, with 32 p.c. falling to the shares of the USA and Great Britain alone. In other words, the highly developed "rich" nations have the right to the lion's share of this additional purchasing power for practically nothing, whereas the "poor" LDCs have to be content with the remaining 28 p.c. In reply to this argument the industrialised countries point out that development aid requires a steadily increasing volume of capital, whereas the SDRs are exposed to possible fluctuations and interruptions. There are however no compelling reasons why the high costs of building a hospital, a port or a dam should necessitate consequential expenditure of the same order. Besides, a certain degree of continuity in the cash flow has already been assured through the practice of creating SDRs for a period of several years.

### A Fresh Source of Inflation?

One of the weightiest arguments the industrialised countries are advancing against the "link" is that it would open up a fresh source of inflation. If one wishes to examine the question more closely, one must proceed from the fact that SDRs are a form of credit creation on an international scale. As such their effect may, but need not necessarily, be inflationary. As instruments for creating credit, the effect of SDRs internationally is basically similar to the effects any internal expansion of credit produces. These effects are inflationary, if they are

not consolidated by corresponding savings or if the supplies are inelastic because industry is already working at full capacity. If, on the other hand, output capacities of the countries in receipt of SDRs are not fully utilised, if they are underemployed, then the donor countries need make no sacrifices. (This has already been pointed out by T. Scitovski). On the contrary, they may in certain circumstances even derive some direct benefit from such action by way of the well-known employment effects. In conditions of full employment, the effects of SDRs are indeed inflationary. Not only that: the transfer process requires in addition a readiness on the part of the donor countries to curtail their own demand – a readiness that cannot be automatically taken for granted.

### Thorough Examination Needed

The success of the transfer process depends therefore in no small measure on the degree of determination with which the industrialised countries pursue a policy of full employment. If indeed one considers the order of magnitude that is at stake, the inflation argument loses still more of its force. Assuming that some \$ 3 bn worth of SDRs are created annually for the industrial countries, of which they cede, say via IDA, anything between 25 and 75 p.c. to the LDCs, the effective international demand would rise by 0.75 to 2.25 bn \$. Considering that in 1970 capital transfers from DAC-countries to LDCs totalled \$ 15.6 bn, it must be admitted that the additional amount by which international demand would rise is relatively small when compared to the volume of internal credits that are normally created. The additional demand may have a (small) inflationary effect, but it is in any event only one factor among many others. It is therefore unreasonable to describe the ceded SDRs as "the inflationary straw that breaks the camel's back" (Reuss).

The question is simply this: With the aid of SDRs the group of the "rich" countries has been enabled by way of creating credit to effect a transfer of resources from other countries. These "rich" countries are reluctant to grant the same facilities to countries that really need them, at least not to anything like the same extent. What objections would there be to searching for a way that would enable countries wanting to acquire SDRs for balance of payments reasons really to "earn" them? Is transfer via IDA really so inappropriate? Do the industrialised countries really expect to retain their credibility as far as development aid is concerned, if they do not examine the arguments for and against such possibilities more seriously, if only to underpin their own point of view with more solid arguments?

On one point however the arguments of those against the "link" are not so easily dismissed; it is this: Too liberal a creation of SDRs, possibly even through a basic change in the majority situation in the IMF, may offend against the scarcity principle to which in the last resort every kind of money owes its ability to function. It may indeed be possible that for technical reasons a mixing up of monetary policy with development aid proves to be inadvisable. But such technical

reasons should not blur the basic idea that new ways of transferring resources must be found, if development policy is to remain effective and credible. This is why it is well worthwhile thinking carefully whether international credit creation could not be used for purposes of development aid. The conditions should be such as to permit the young countries to build up a strong infrastructure without for ever feeling the iron hand of their creditors closing round their necks.

## Special Drawing Rights and Development Aid

by Dr Dietrich Kebschull, Hamburg \*

**The introduction of the Special Drawing Rights (SDRs) has not fulfilled the wishes of the LDCs. Whereas the industrialised countries look upon SDRs simply as international liquidity reserves, LDCs aim at the linking of SDRs with development aid. Is their concept really as out of place as the industrialised countries maintain it is?**

**T**he industrial countries which have command over the absolute majority in the International Monetary Fund (IMF) utilise the SDRs in accordance with their own requirements. In their view the SDRs are meant to serve two main purposes:

☐ To satisfy the liquidity requirements of the great trading nations, continuously growing, as they do, in the wake of world trade expansion. (In this context the SDRs are of particular significance because they do not only represent additional reserve media aside the traditional reserves but are also meant to offset the declining importance of the pound, the dollar and gold.)

☐ To counter-balance short-term balance of payments deficits which, at growing volume of a country's foreign trade, necessarily appear more often because of the time gap between the flows of goods and the flows of capital.

### Restricting Regulations

For the purpose of upholding the reserve criterion and, at the same time, to safeguard against any undue deployment and creation of SDRs, the obligation of reconstitution was introduced. It entails the duty that, five years after the first allocation and thereafter at the end of each quarter, a total of at least 30 p.c. of the allocated SDRs must — in spite of prior utilisation — have been reconstituted. The aim of this direction is the avoidance of SDRs

being used as reserves under balance of payments aspects and, in the extreme, exclusively for the financing of imports.

In order to avoid an exaggerated creation of SDRs, the EEC countries also made sure of a blocking minority. 85 p.c. of the IMF votes are necessary before new SDRs can be created. The EEC countries among them have 16.2 p.c. of the votes.

### Demands of the LDCs

The allocation of SDRs is based on present IMF quotas. According to the LDCs the SDRs and their allocation system fall short of their special requirements. The LDCs are less concerned with reserves to combat balance of payments imbalances but rather with additional financial means to be put at their disposal by the industrialised countries.

In order to obtain more capital for development purposes they emphatically demand a link between SDRs of the developed countries and development aid. There are two different basic patterns in the propositions for such a link:

☐ A part of the industrial countries' SDRs is to be put at the disposal of the International Development Agency (IDA) after the allocation by the IMF. IDA subsequently exchanges these SDRs into the currency of the relevant industrialised countries and

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