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Article — Digitized Version

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Intereconomics

Suggested Citation: Küng, Emil (1976) : Economic stagnation and development aid, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 11, Iss. 10, pp. 275-278,
<https://doi.org/10.1007/BF02929199>

This Version is available at:

<https://hdl.handle.net/10419/139414>

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Economic Stagnation and Development Aid

by Professor Emil K  ng, St. Gall *

The main objectors to a link being established between special drawing rights (SDRs) and the financing of development have in the past been the industrial countries. They have been pointing out that SDRs were created for other purposes – more effective control over international liquidity – and that a link with development finance would have an inflationary effect. If however the present unemployment situation in the industrial countries should become at least partly a permanent feature the idea of such a link would become more attractive than hitherto – to the industrial countries.

In creating special drawing rights (SDRs) the International Monetary Fund has for the first time in history created an instrument which makes it possible to exercise an influence on the global economic situation. In fact, given sufficient courage, it would be possible to engineer an expansive cyclical policy on a world-wide and not only on a national scale. Such a procedure is of course unlikely to be adopted as long as at least all industrial countries do not find themselves at the same stage of recession or, in other words, as long as there exists a "cyclical seesaw" where for instance the United States is experiencing boom conditions while Europe is stuck in a cyclical trough.

More recent developments have shown however that cyclical fluctuations are in fact tending to become somewhat more synchronized, which means that the cyclical seesaw argument against using the new instrument is losing much of its force. True, other misgivings remain, particularly about the idea that SDRs could also be used to combat poverty in LDCs. It is particularly against this notion that the opponents to a link remind its advocates of the fact that SDRs were created for quite a different purpose, i.e. to improve the control of the world economy's regular supply of monetary reserves.

It is of course undeniable that at present the world at large suffers from an excess of liquidity rather than a scarcity of monetary resources. This is due to the fact that at the time when the United States incurred large balance-of-payments deficits, non-American central banks were inundated with dollars, highly increasing the foreign-exchange component of their currency reserves. Another reason is that ever since the value of monetary gold stocks can be assessed only by reference to their price on the free market, the gold component has risen in value to several times its previous figure.

It must finally not be forgotten that the Euromarket and the increase in the price of oil have opened up fresh sources from which new reserves have flown, while at the same time, as a result of going over to floating, the need for funds for the surplus settlement of balances of payments decreased. In accordance with these developments, there was no need for issuing any further SDRs, after the first issue of about \$ 9.5 bn.

New Preconditions

All these arguments are undoubtedly founded on facts. But when it is said that an instrument may only be used for what it was originally designed, then it is difficult to agree. Should it turn out that by applying the instrument to purposes other than those for which it was designed it may be possible to achieve other important aims, one must not be afraid to revise one's original ideas. After all, taxes which initially were exclusively levied to provide the state with revenue, have subsequently been used to further certain cyclical policies and other aims.

It would of course be feasible simply to distribute the already existing SDRs or any other monetary reserves in some other form, and, in fact, some modest beginnings in this direction have been made with the gold of the International Monetary Fund. But this is hardly the way to advance development aid on a larger scale, for this national egoisms are too powerful; industrial countries simply would not agree to yet more presents being made to poor LDCs. On the contrary, grants of this kind tend to be curtailed when one is oneself in economic difficulties. Besides, the situation in the "poor South" is constantly growing more precarious as the oil price increase bites deeply into the economic life of these countries, the chances of selling their exports in the industrial

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countries leave definitely much to be desired and foreign indebtedness reaches in many LDCs alarming proportions.

To the picture outlined above some new features have most recently been added by the fact that economic developments in the "rich North" appear to be marked for some time to come by significant lower average growth rates than had been recorded in the past few decades. Naturally, a cyclical upswing brings with it more favourable conditions — but temporary ones only. It is in particular hardly possible to avoid the impression that such an upturn will not be able to solve effectively the present unemployment problem. The prevailing opinion is rather that a certain residue of unemployment is likely to remain.

However, if we should have to reckon with unemployment as a permanent feature, the linking of special drawing rights with development aid becomes a much more attractive proposition than it was before — attractive that is to industrial countries. At first, of course, they will endeavour to overcome their difficulties as best they can on a regional basis. For this purpose they will deliberately accept deficits in their state budgets; measures for the protection of the environment will be undertaken and the public transport system will be extended. But should it really turn out to be true that within the next ten or twenty years the human and material production capacities remain on average only insufficiently used then the injections of additional purchasing power will increasingly assume the character of emergency measures — for less and less urgent projects. The unemployed would have to be made to do jobs for which they have not been trained and the state's indebtedness would assume ever greater dimensions as will the inevitable interest payments.

LDCs without oil deposits or raw materials face the possibility of a "circulus vitiosus" developing as with growing poverty the population continues to explode, or maybe because the stagnation in the industrial countries depresses prices of primary commodities, leading to a deterioration in the terms of trade for the LDCs or possibly because the rich North, acting under the pressure of unemployment, cancels previously granted preferential customs duties or introduces some other protectionist measures.

Should something like this happen, we would face a world divided into two camps — the one needing gigantic quantities of industrial goods but without the means of satisfying that need, whereas the other camp would in principle wish for nothing better than to manufacture and sell more goods but being unable to do so. The set of problems engendered by such a state of affairs would be remarkably similar to those with which coun-

tries were confronted on the national level in the thirties. A certain parallel can also be drawn with the period following World War II when an acute shortage of foreign exchange reigned in war-devastated Europe, there simply not being enough available to satisfy the demand for imported goods. On the first occasion it was Keynes who showed how it was possible to get rid of cyclical mass unemployment. On the second occasion it was the Marshall Plan which established a bridge between demand, on the one side, and production capacity, on the other, by making the necessary purchasing power available.

Killing Two Birds with One Stone

Today it is the SDRs whose construction would enable them to link the two camps together. For also in their case it is a question of purchasing power created from nothingness and then handed over to those who are in need of it. We can be assured that this purchasing power will be employed — employed for the acquisition of foreign exchange needed to pay for import goods. This way a flow of goods from the North to the South will be initiated while simultaneously SDRs will flow in the opposite direction, which finally will be accumulated in the industrial nations' currency reserves.

Once this process has been set in motion, it should be possible first of all to relieve poverty where it is most acute and where it may even threaten to become worse. The industrial countries for their part would experience a revival of demand. This revival would help to overcome the obstinate tendency towards underemployment which is said to be due to stagnating population figures and the lack of impulses emanating from technical advances. In our present context it is of particular importance that under the proposed scheme most of the unemployed labour force could return to their old jobs. Besides, it must not be forgotten that as a secondary effect the circular flow of goods between the industrial countries will likewise receive a fresh impetus.

In order to make the project attractive to the industrial countries and it is these who want convincing — it would have to be pointed out to them that the deficits incurred by the state could be reduced as the reintegration of the unemployed progresses and that in turn would lead to a lessening of the public debt and the interest payments on it. Admittedly, the delivery of goods more or less free of charge represents for the manufacturing countries a material economic burden. But this burden is nothing like as heavy as it would be in a state of full employment, for in the present state of underemployment the citizens of the rich North would hardly have to renounce a thing.

This also shows the limits to which the aid may be extended: these limits lie between the existing insufficiently utilized output capacity and a nearly fully utilized one. Provided one keeps within these limits there can be no question of any appreciable loss of prosperity occurring as a result of such a scheme. On the contrary the social costs involved in total unemployment and short-time work will be reduced.

In addition, there is of course the fact that public expenditures in the form of unemployment benefits will diminish, while, because of increases in national incomes, public revenues, notably tax yields, will increase. As for the private companies, they will see that the better utilization of the output capacities will result in lower costs per unit produced and thus in higher profits. Prospects for the future become brighter and both the capacity and the propensity to invest should increase. This does not mean, of course, that the structural problems of individual branches can be resolved in the manner described. It is already quite sufficient if in other sectors of industry better opportunities are created for absorbing the pool of unemployed manpower. Besides, the tasks of an ecological nature confronting us are by no means becoming lighter for there are no signs of finite natural resources being used more sparingly nor is the problem for recycling waste-material being tackled with much energy. In the circumstances one will have to be content to see at least two birds killed with one stone.

How to Set About It

If the appeal to the self-interest of the industrial countries is to be successful, the additional development aid must clearly not come about through the usual channels. In other words, one must not begin by creaming off purchasing power from the tax-payer and subsequently pass it on to the LDCs in the form of presents or credits. Instead new purchasing power must really be put into circulation. The most obvious step towards this aim would seem to be an issue of SDRs which would however not be allotted in the traditional way in accordance with the national quotas, but given exclusively to the poorest of the countries. Another variant likely to produce the same effect would be that the industrial countries voluntarily cede their quotas of SDRs to the national economies in need.

Both methods have their well-known drawbacks, however. There are reasons to fear that the governments and central banks of the recipient countries which would be the first to come into possession of these international means of payment and thus of foreign currencies may use them for improper purposes: they may use only part of the funds for the financing of long-term development

projects or poor relief and allow the rest to leak into the pockets of some favoured members of the ruling oligarchy. There is nothing to prevent such leakages, if the recipient countries are given the right of free disposal of the funds.

In view of the possibility of such misappropriations occurring another procedure would seem to be more appropriate. It would consist in the International Monetary Fund transferring the SDRs direct to the World Bank. Alternatively the industrial countries might undertake the transfer to the World Bank themselves. Bolstered up by this additional cash, the World Bank and particularly one of its subsidiaries, the International Development Association (IDA), would be in a position to grant very much larger loans for the financing of certain specific projects. Naturally these loans would no longer be mere presents. On the other hand, credits advanced by IDA are granted on such "soft terms" that in practice they come pretty close to being presents. Furthermore it must be emphasized that in these days SDRs carry in any event interest charges. The great advantage inherent in such a "link" is of course that the experts of the World Bank are the best qualified to judge whether the funds are actually used for the purpose for which they were intended.

The Danger of Inflation

It stands to reason that in conclusion it is necessary to refer once again in detail to the most sensitive point of the entire proposal and to those arguments which we cited earlier, against an increase in world currency reserves. We may begin by pointing out that, in contrast with earlier years, the American balance of payments now shows a surplus. As long as this is the case the United States could pay off its short-term foreign indebtedness. To the extent that this is done, dollars forming at present part of the monetary reserves of non-American central banks will flow back into their "homeland" where they will become once again ordinary national means of payment and the total reserves will drop in consequence. This does not necessarily mean, however, that such a trend could not be more than compensated for by other forces.

It is further worth mentioning that in industrial countries better utilization of capacity is generally accompanied by falling unit costs. Therefore it is not immediately clear why prices should rise. If they do rise nevertheless although in the prevailing stagnation pressure of competition has increased, the reason for this is neither imported inflation nor excessive demand; it is undoubtedly a typical home-made cost-inflation. Wherever this type of inflation appears in a state it must be taken to be a sign of failure — failure of the economic policy,

failure to correct imbalances in the internal power structure, structural or institutional failures, faulty thinking and attitudes. It is evident that such faults have nothing to do with supplying the world with monetary reserves.

The situation is of course particularly precarious in countries which are in the throes of the "English malaise", where underemployment and inflation are simultaneously damaging the economy. Where this sickness of our civilization occurs in a milder form, the competent authorities see themselves obliged to take measures against unemployment. Why then should not such measures be envisaged on a world-wide, and not only a national scale, particularly in view of the fact that the projects planned in the poor South are incomparably more urgent and important than those of the rich North.

That their realization would inevitably lead to increased export revenues for the industrial countries and to an expansion of the money supply is generally accepted. What is still open to question is how this can be harmonized with floating and with the autonomous regulation of national money supplies according to which the increase in the monetary base must not excede a certain annual limit. The problem may be illustrated by the Swiss example: Switzerland buys up annually currency reserves of the order of sfr 1 500 mn, but if at all possible no more. In other words, the monetary expansion is to keep within these limits. Whether the reserves are in the form of SDRs or in any other payment media is of secondary importance. Measured in terms of the gross national product, the permitted increase amounts to roughly 1 p.c.

True, in those national economies which are members of the International Monetary Fund excess countries are obliged to accept SDRs up to a limit of 200 p.c. of their quota — but, for the time being at least, no more. Here, too, it would be possible in the course of time for bottlenecks to develop as long as the present order is allowed to remain unchanged. Any change would have to be in the direction of replacing the present limited obligation to accept SDRs as legal tender by an unlimited one. This would mean for SDRs on an

international scale the introduction of the same "forced rate" as it has for long been existing in individual national economies for their national payment media: every creditor is obliged to accept them in discharge of debt. In this way SDRs would become a kind of "world currency".

A development in this direction would be nothing but logical, if one keeps in mind that the new reserve medium is also to serve the purposes of global cyclical policy and help to combat stagnation and poverty on a planetary scale. In this way a certain "international fiscal adjustment" would be set in motion between rich and poor, replacing the threatening confrontation by cooperation. It has already been mentioned that in practice it cannot be merely a question of re-distributing existing liquidity, but only one of creating additional means of payment. And here, admittedly, is the most vulnerable part of the entire scheme.

It is worth recalling however, that at the International Monetary Fund a qualified majority of 80 or 85 p.c. is required for the adoption of a decision to make a new issue of SDRs. The present distribution of votes gives this majority to the industrial countries. It is they therefore that need convincing of the merits of the scheme. In this context just one more statistical argument: if new SDRs were issued at an annual rate of \$ 1 bn, this would be tantamount to less than one tenth percent of the gross national product of the industrial countries. Even at \$ 10 bn per annum the expansionist impulse produced would be no more than one percent of total output.

If one keeps this order of magnitude in mind and confronts it with the millions of unemployed in the rich North — millions which are unlikely to vanish even at times when the economy is booming, the danger of inflation threatening from the issue of some additional SDRs looks rather a small risk to bear. If in many industrial countries near-full employment is incompatible with relative price stability, the time has come for these countries to remedy the situation. What is intended is merely to fill the gap that exists between the effective and the potential output volume and to pass on the resulting plus in the shape of goods to the poor of this earth.

KONJUNKTUR VON MORGEN

The short report on domestic and world business trends and raw material markets
published every fortnight by HWWA-Institut für Wirtschaftsforschung — Hamburg

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