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Klaus Didszun\*

## The Debt Crisis and IMF Policy

*The discussions anticipating the annual joint meeting of the IMF and the World Bank in Berlin this autumn have again drawn the increased attention of a broader public to the debt problems of the developing countries. Alternative groups are planning to hold an anti-congress, in which especially the role of the IMF and the World Bank in this connection are to be subjected to a critical examination. The following article describes the basic points of criticism.*

The International Monetary Fund makes its financial support dependent on the implementation of adjustment measures in the countries requesting support (conditionality of the Fund). The measures are concentrated largely on the reduction of overall effective demand – this in particular has provoked the critics – and not until recent years was increased attention devoted in the Fund's deliberations to growth policy aspects.

There have been attempts in the literature to minimize the severity of conditionality policy by pointing out the low share of IMF loans with hard conditions in total lending to developing countries. But since the commercial banks, regional development banks, public lenders and the Paris Club make the commitment of funds dependent on the "seal of quality" of an IMF-supported adjustment programme, this acts as a leverage for the Fund to exert a decisive influence on the economic policies of the developing countries.<sup>1</sup> This function has receded into the background for the moment, however, due to the reticence of the commercial banks regarding lending. At present the increased cooperation between IMF and World Bank is a more important subject of discussion. If the lending of the one is made dependent on fulfilment of the conditionality of the other (cross-conditionality), this would, in the opinion of the "Group of 24", mean the introduction of an additional conditionality, which could not be accepted.<sup>2</sup>

The danger is that the non-fulfilment of (restrictive) demand-orientated IMF conditions could also lead to the blocking of World Bank funds for long-term infrastructural measures. Although the IMF speaks in its annual report for 1987 of avoiding such a procedure, it

leaves entirely open how its principle is to be interpreted that in all questions in connection with structural adjustment loans complete agreement between both institutions must be reached on all important points.<sup>3</sup>

Due to pressure from the USA, the multilateral development banks and the World Bank subsidiary IDA (International Development Agency) are to reduce their share of "soft" loans and tie their loans to strict conditions regarding the domestic economic policy of the recipient country.<sup>4</sup>

Recently, within the framework of "enhanced surveillance", the examination and development of stabilisation programmes (for which other lenders provide the funds) has become the main task of the Fund, so that there can be no doubt as to the importance of conditionality. In this situation additional responsibility accrues to the IMF and the World Bank for fundamental long-term development processes in the Third World.

### Overkill

One accusation made against the adjustment programmes initiated by the IMF is that the intensity of intervention of IMF conditionality is not economically justified when compared to the adjustment necessary and that it thus tends to hinder the longer-term structural development aimed at.<sup>5</sup> This exaggeratedly large dose

<sup>1</sup> K. Wohlmuth: Konditionierte externe Entwicklungsfinanzierung und interne Strukturanpassung in den Entwicklungsländern, in: Schriften des Vereins für Socialpolitik, Vol. 136, Berlin 1983, p. 183.

<sup>2</sup> Schuldenkrise, Zwist um Auflagen, in: Wirtschaftswoche, No. 42, 11. 10. 1985, p. 18.

<sup>3</sup> IMF: Annual Report 1987, p. 75.

<sup>4</sup> Bernhard May: Der amerikanische Beitrag zur multilateralen Entwicklungshilfe, in: Europa-Archiv, No. 18, 1986, p. 535; Frankfurter Rundschau, 28. 3. 1988, p. 6.

<sup>5</sup> S. Dell: Stabilization: The Political Economy of Overkill, in: J. Williamson (ed.): IMF Conditionality, Washington D.C. 1983, p. 17.

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is probably due to the pressure exerted by the necessity of rapidly resolving the debt crisis.

Referring to Williamson and Diaz-Alejandro, Wohlmuth argues that in a number of countries less restrictive measures would with a high degree of probability have led to the same result.<sup>6</sup> Overkill takes place when the reduction of demand via a too restrictive credit and fiscal policy together with a policy of the reduction of real wages goes beyond that which is necessary to free capacities for the production of exportable goods. This leads, via falling capacity utilization, to a massive reduction in productive capacity and thus to losses in growth and employment. While the falling imports of consumer and capital goods set foreign exchange free for better debt servicing, at the same time there is an exacerbation of long-term, i.e. structural, adjustment problems.

A classical example of this is the adjustment in Peru after 1976: following the failure of fiscal restrictions the private sector and wage earners had to carry the main burden of adjustment. High rates of interest and the reduction of real wages narrowed the domestic market for industrial products to such an extent that there was a dramatic slump in private investment, and this although both in industry and in the services sector there were already considerable unutilized capacities. Furthermore, such a stabilisation policy leads to lower tax receipts and the budget deficit increases. This in turn can lead to mistakes in diagnosis and therapy.<sup>7</sup>

If on the other hand government expenditure is drastically curtailed, as was the case in 1987 particularly in the fuel-exporting developing countries, domestic demand falls and overall production stagnates.<sup>8</sup>

It is therefore only consequent when the chairman of the board of Citicorp, John S. Reed, demands speedy rethinking on the part of IMF and World Bank. He considers the financing of structural adjustment, which allow exports and growth in the debtor countries to increase, to be more important than demands for usually unsuccessful budgetary reforms, upon which the IMF has until now insisted.<sup>9</sup>

Finally, it is pointed out that this type of restrictive adjustment strategy has taken insufficient account of

international reactions. The parallel reduction of deficits embodies the danger of "downward adjustment competition". An approach with a low level of intervention must therefore be aimed for which leads to the highest possible measure of expansive stabilisation.

It must be regarded as extremely dubious when developing countries undertake a drastic reduction of imports just to maintain their short-term debt-servicing capability. Thus, the investment ratio in 1984/85 shrank compared to 1980/81 by 38% in Venezuela, 23% in Mexico, 26% in Brazil and 24% in Argentina.<sup>10</sup> Reisen is of the opinion that the investment ratios have shrunk to such a low level that a continuous consumption of the economy's capital stock is to be suspected. The aging of plant means a loss in international competitiveness and a worsening of longer-term debt-servicing capabilities. In addition, the economy will prove incapable of absorbing the rapidly growing labour force.<sup>11</sup>

### Effects of Devaluation

There is yet another aspect to this. Up till now the devaluation of the local currency has been an essential part of the IMF reform programmes. This was regarded as an adequate means of restoring the international competitiveness of the debtor countries. With the growth of total debt, however, a negative effect is coming more into the foreground: real devaluations increase the burden of debt service, which is defined in foreign currency. Export quantities must be increased in order to earn the same sum in foreign currency as originally. This means that stocks of raw materials are exhausted more quickly and that supplies on the domestic market from agricultural and industrial production are reduced. Domestic absorption must repeatedly be cut back.

Since these downward adjustment processes have today reached the limits of that which can be regarded in the debtor countries as economically, socially and politically acceptable,<sup>12</sup> it seems cynical that it is recommended to reduce the necessity of real devaluations from the beginning by skimming off via credit policy the purchasing power to be transferred.<sup>13</sup>

Reisen even lags behind the IMF here, which sees in the "persistent fall in the standard of living" particularly in African countries a reason for "serious concern",<sup>14</sup>

<sup>6</sup> K. Wohlmuth, *op. cit.*, p. 179.

<sup>7</sup> *Ibid.*, p. 212.

<sup>8</sup> IMF: Annual Report 1987, p. 9.

<sup>9</sup> K. Handschuch: Lateinamerika: Gemeinsam stark, in: *Wirtschaftswoche* of 20. 11. 1987, p. 42.

<sup>10</sup> H. Reisen: Über das Transferproblem hochverschuldeter Entwicklungsländer, Baden-Baden 1987, p. 118.

<sup>11</sup> *Ibid.*

<sup>12</sup> At the end of 1986 per capita income in 13 of 25 Latin American countries was 10% lower than in 1980, in 7 more than 15% lower and in 4 more than 20% (in Bolivia 27%). Cf. Inter-American Development Bank: Economic and Social Progress in Latin America, 1987 Report, p. 1 f.

<sup>13</sup> H. Reisen, *op. cit.*, p. 196.

<sup>14</sup> IMF: Annual Report 1987, p. 11.

and which the World Bank describes not only as a falling average living standard but as a "relapse into poverty by large sections of the populations".<sup>15</sup> Even supporters of conditionality policy now voice doubts as to whether collapsing economies can be given the necessary stimuli to growth via IMF adjustment programmes alone.<sup>16</sup>

### Too Narrow Time Horizon

A point of criticism of IMF policy which recurs continually in the literature is the too narrow time horizon of the consolidation programmes which, with their emphasis on macroeconomic stabilisation, underestimate in particular the structurally conditioned adjustment difficulties of the low income countries.<sup>17</sup>

Deep-rooted problems such as underdeveloped human potential and a minimum of institutional and material infrastructure make market-controlled adjustment processes difficult and can only be combatted in the long term. Accordingly, the question of adjustment capacity, i.e. the level of development of a country, should be taken more into consideration when adjustment programmes are being designed. Restrictions on demand can only set exportable resources free in semi-industrialised countries, whereas in others there are no capacities for an enlarged supply of exports. Furthermore, stabilisation programmes with a shorter time horizon will show greater effects on employment and income than longer-term programmes. The relatively brief period of credit extension is justified with the argument that this corresponds to the character of the IMF Agreement and that structural adjustment is the task of World Bank loans.

A certain improvement was brought by the revision of the guidelines in 1979, following which stand-by agreements could under certain circumstances run for up to three years (previously one year). This makes it possible for the first time to take the possibility of an adjustment oriented towards supply into account. However, this extension of the time limit is regarded

today (also by the IMF) as inadequate. For if in addition there are impeding external factors such as, for example, a collapse of the prices of a country's main export goods or an increase in the international interest rate level, then the beginnings of reform achieved in lengthy rescheduling negotiations will become obsolete. The coupling of payment obligations to economic trends in the debtor country therefore appears indispensable. It is to be welcomed that the Interim Committee of the IMF achieved agreement in April this year on the creation of a new external contingency mechanism.

### Sociopolitical Aspects

When the publications on conditionality policy are examined, it is conspicuous that although the economic objections are the subject of serious discussion, the demand that minimal sociopolitical requirements be taken into consideration is the subject of formulations such as "philanthropic maxim of world development policy" or "inclination to ideological protest".<sup>18</sup> Above all, demands in this direction are refuted with the argument that the Fund is prevented by law from influencing the micro level.

In my opinion elementary ingredients of our guiding economic principles are ignored here and the decision concerning a country's political system is judged simply according to the criterium of economic efficiency. And finally, it is not recognised that adequate health, nutrition and education are basic conditions for human efficiency and productivity and the basis for long-term economic growth.

Although the IMF, when it passed the new guidelines on 2nd March 1979, intended that the concrete conditions attached to the adjustment programmes should be harmonized with social, political and economic priorities, there have until now been no visible signs that this has found its way into the Fund programmes. The Fund, rather, according to statements by its employees<sup>19</sup> even now places particular importance on the achievement of balance of payments targets, and with regard to other domestic targets aimed at for reasons of justice or for social and political reasons it follows the "principle of political neutrality". In 1984 Larosière said, "An international institution such as the Fund cannot presume to dictate social and political targets to sovereign governments . . ." <sup>20</sup> One cannot avoid the impression that the 1979 guidelines have thus degenerated to an empty formula and that they have only an alibi function. Susan George points out that it was precisely those countries which most emphatically insisted on the setting of social targets which also had

<sup>15</sup> World Bank: World Debt Tables 1987-88, Vol. I, p. ix.

<sup>16</sup> M. Deppisch-Hubmann: Die Rolle des IWF in der Schuldenkrise II, in: Zeitschrift für das gesamte Kreditwesen, 21/1986, p. 986; P. Nunnenkamp: Das internationale Schuldenproblem, Kieler Diskussionsbeiträge No. 117, Kiel 1986, p. 3, footnote 1.

<sup>17</sup> H. Körner: Auslandsverschuldung der Entwicklungsländer und interne Anpassungsprozesse, in: Schriften des Vereins für Socialpolitik, Vol. 144, Berlin 1984, p. 30.

<sup>18</sup> Ibid., p. 36; H.-B. Schäfer: Die Bereitschaftsabkommen des IWF in der Kritik, in: H.-B. Schäfer (ed.): Gefährdete Weltfinanzen, Bonn 1980, p. 235.

<sup>19</sup> Cf. the magazine "Finance & Development".

<sup>20</sup> J. de Larosière: Does the Fund Impose Austerity?, IMF brochure, June 1984.

the greatest difficulties in coming to an agreement with the Fund.<sup>21</sup> For this reason a number of authors plead that the question of the distribution of adjustment burdens within a country be made an explicit ingredient of conditionality.<sup>22</sup> Killick points out, "Fund missions provide policy advice on BoP, price stabilisation and growth aspects of its programmes" and asks, rightly, "on what principle can it decline to do so for the distribution results?"<sup>23</sup>

Certainly, on the part of the governments involved and of the hitherto privileged strong resistance is to be expected to allowing the Fund to exert an influence in this sphere. A quotation may serve to elucidate the problem: "Of the 770,000 Argentinian tax-payers in 1985, 730,000 paid on average US-\$ 170 per annum for value added tax, income tax, capital tax and property tax. If the income and property declarations of the self-employed are to be believed, their houses had an average value of US-\$ 7,500 and they earned US-\$ 150 per week."<sup>24</sup> The problem of the existing structures of power is with certainty one of the greatest barriers in the sphere of development policy. Thus, Mols<sup>25</sup> characterises the Latin American countries as "distributionally extremely distorted societies which neglect some to the point of pure exploitation and allow others a standard of living which literally lets them live in another world".

### Effects at the Micro Level

Although the IMF deliberately limits its adjustment measures to imposing macroeconomic policy conditions because of the principle of "political neutrality", it must be pointed out that they (directly and indirectly) have a strong influence on the micro level:

- ☐ The reduction of budget deficits can lead to the limitation of indirectly productive welfare programmes. In Jamaica, for example, anti-mosquito measures had to be stopped because there was no money for new sprayers. When vaccination programmes for school-children were cut back, deaths from polio reoccurred.<sup>26</sup>
- ☐ The curbing of imports and devaluation lead to the limitation and the increase in prices of imported spare parts for medical apparatus and medicines for existing health services.
- ☐ The increase in mineral oil prices and taxes, via the increase in transport prices which it caused, particularly hit the poor, who often live on the periphery of the cities and are dependent on cheap transport to their place of work, to school and to the markets.
- ☐ The rise in the prices of foodstuffs has led to an increase in undernourishment, diseases caused by

hunger and death rates among children. (Up to 70 % of a wage-earner's household budget is spent on food.)

When the argument comes from supply-oriented quarters that the rehabilitation of the developing countries can only be achieved via budgetary reform and that only the growth resulting from this can in the medium term make possible an improvement in the social situation of those groups which are hardest hit, then in my opinion this can only be accepted politically if the period can be estimated within which verifiable progress will take place. The years 1980 to 1986 are, however, only evidence of a trend in the opposite direction:

- ☐ In the majority of countries in Latin America per capita expenditure on education was lower in 1986 than at the beginning of the decade.<sup>27</sup> School registration ratios fell and the number of drop-outs rose (due to poverty?) in a number of countries.
- ☐ Health conditions today have fallen behind those of 1980.<sup>28</sup>

### Growth and Social Progress

Apart from that, it is not proven that there is an automatic linkage between economic growth and social progress in developing countries. In an examination of the satisfaction of basic needs in 22 Latin American countries Sangmeister ascertained that some countries with a moderate resource endowment and chronic economic difficulties showed more favourable values in the spheres of health, nutrition, education and sanitation than, for example, the newly industrialising country of Brazil.<sup>29</sup>

In view of these facts, solutions must be found which are at least socially acceptable and appropriate from a distributional point of view, such as those proposed by Pfeffermann. In June 1987 he undertook, as an employee of the World Bank, what he states to be the first attempt (!) to examine the standard of living of the

<sup>21</sup> S. George: *Sie sterben an unserem Geld*, Hamburg 1988, p. 77 (Original title: *A Fate Worse Than Debt*).

<sup>22</sup> V. Büttner: *Die Außenpolitik des IWF im Kontext der internationalen Schuldenkrise*, in: *Schriften des Vereins für Socialpolitik*, Vol. 144, Berlin 1984, p. 96.

<sup>23</sup> T. Killick: *The Quest of Economic Stabilisation*, London 1984, p. 246.

<sup>24</sup> H. Reisen, *op. cit.*, p. 149.

<sup>25</sup> M. Mols: *Demokratie in Lateinamerika*, Stuttgart 1985, p. 153.

<sup>26</sup> S. George, *op. cit.*, p. 252.

<sup>27</sup> Inter-American Development Bank, *op. cit.*, p. 63.

<sup>28</sup> G. Pfeffermann: *Economic Crisis and the Poor in Some Latin American Countries*, in: *Finance & Development*, No. 2, 1987, p. 33.

<sup>29</sup> Cf. *Die Zeit*, 13. 5. 1988, p. 34.

poor in Latin America and the Caribbean.<sup>30</sup> Pfeffermann demands that general cut-backs in expenditure must be accompanied by efforts to protect the interests of the poor. This could be achieved by a critical review of general subsidies, which should however be accompanied by cross-subsidies favouring the poor. This would not place an additional burden on the budget. He proposes the following ad hoc measures:

- ☐ job creation programmes;
- ☐ targeted food subsidies through a food-stamp system (instead of general subsidies);
- ☐ the distribution of food to families with malnourished children;
- ☐ realistic charges for social security and public health services (which are used by the middle classes) and the expansion of primary health care networks;
- ☐ differentiation of electricity and water rates according to location or the volume consumed.

The view is apparently only slowly gaining ground that countries which find themselves in the process of adjustment can only be assisted by targeted direct measures to ameliorate the social effects of adjustment.<sup>31</sup> The fund could increase its acceptance by the majority of the population via an extended conditionality of this kind.

### The Question of Democracy

Schäfer accuses the IMF of diminishing its field of vision, of deliberately ignoring interdependencies: in the formulation of adjustment programmes the Fund should also have been guided by the question as to which burdens a political system can possibly bear without collapsing.<sup>32</sup> It is not a coincidence, he claims, that many of the most important adjustment programmes have been carried through by brutal military régimes, which have banned organisations, abolished civil rights and resorted to violent repression.

The effects of the consolidation programmes result in a process of destabilisation on the social and political level. Evidence of this are reports of hunger revolts and their bloody suppression. In Matthöfers opinion there

are limits to the extent to which human misery can be escalated and which people are prepared to endure: "At a certain point the threat to existence awakes self-help mechanisms which disregard public rules of order. The rule of law loses its legitimation when it begins in favour of one section of the population to allow another to starve." The governability of these countries is increasingly jeopardized, he says. In Brazil for example, IMF stabilisation programmes can no longer be effected.<sup>33</sup>

Silva-Herzog, the previous Mexican finance minister is right when he says that austerity and democracy cannot coexist for very long.<sup>34</sup> Unfortunately it is true that the fulfilment of the policy conditions that are part of IMF programmes can be achieved more easily with the assistance of authoritarian structures than with that of a democratic government struggling for its political survival.

### Ecological Aspects

The worldwide devastation of the environment has been ascertained and criticised in a wide variety of areas. The dangers emanating from this have either not been sufficiently recognised by, above all, developing countries, or corruption prevents the application of legal regulations, or the funds for targeted measures do not exist. This makes it all the more problematical that the conditions imposed by the IMF in some cases tend to prevent the solving of the conflicts.

One example of these indirect ecological effects is the increasing of the price of kerosene as part of an adjustment programme. The aim of this measure is the more sparing use of this source of energy and the resulting reduction in foreign exchange requirements. The population, however, will in view of its poverty resort to wood as a substitute. The effects are well-known: the clearance of scarce forests has led to considerable erosion damage and the cumulation of flood catastrophes (Andes/Himalaya region).

The compulsion to make drastic savings in public budgets has led to the neglect of urgently necessary environmental investments. Furthermore, the necessity of paying back loans leads to the accelerated exploitation of natural raw materials. In developing countries with tropical forests, for example, deforestation is enforced. The high costs of reafforestation lead to an increase in foreign debt and thus to IMF conditions with regard to a further export orientation. Since foreign exchange can presently only be earned by a more intensive exploitation of wood, the result is considerable pressure on the still existing natural forest areas.

<sup>30</sup> G. Pfeffermann, *op. cit.*, pp. 32 ff.

<sup>31</sup> Y. Huang, P. Nicholas: The Social Costs of Adjustment, in: *Finance & Development*, No. 2, 1987, p. 24.

<sup>32</sup> H.-B. Schäfer, *op. cit.*, pp. 237 f.

<sup>33</sup> H. Matthöfer: Kapitalflucht, Korruption und brudermörderischer Rüstungswettlauf, in: *Frankfurter Rundschau*, 15. 2. 1988, p. 11.

<sup>34</sup> Quoted by D. Hoffmann: Ways out of the Debt Crisis, in: *INTERECONOMICS*, No. 6, 1987, p. 268.

The destruction of tropical rain forests is, finally, also caused by colonisation projects. One example of this is the transmigration from the densely populated Indonesian islands of Java and Bali to the sparsely populated regions of Borneo and Sumatra, where the destruction of natural forest leads to the degradation of the soil, jeopardises stable agricultural forms of soil utilisation and thus offers no guarantee for the long-term livelihood of the 4 million transmigrants to date.<sup>35</sup>

The churches, the Worldwide Fund of Nature and the United Nations Environment Programme (UNEP) regard the abstention by the developing countries from the intensive economic exploitation of tropical forests as the rendering of a hitherto free service to the benefit of the international community. Developing countries should therefore be given compensation payments within the framework of the World Conservation Strategy for their renunciation of commercial profits and export receipts.

This demand is by no means unrealistic: the Bolivian government committed itself in 1987 to place an area of 2.5 million square kilometres in the Amazon Basin under preservation. In return, Bolivia will be relieved of foreign debt to the tune of US-\$ 650,000. The funds for this were put up by a private foundation in San Francisco, which acquired the debt package for US-\$ 100,000.<sup>36</sup>

The Federal German Minister for Economic Cooperation has pleaded in the development committee of the IMF and World Bank for particular consideration of environmental questions when granting credits to developing countries. Because of the approaching "environmental disaster" the industrialised countries should be prepared to carry part of the costs of

countering this "trend which endangers life".<sup>37</sup> It is to be hoped that this is a sign of a fundamental change in the evaluation of ecological problems, for at the end of 1986 the Federal Government still saw no occasion "to resort to further measures beyond its general efforts to take environmental aspects and the protection of resources into consideration".<sup>38</sup>

As the consideration of ecological criteria in developing countries is faced at first with enormous financing gaps the aim must be that rescheduling negotiations are conducted according to broader criteria than simply the increasing of transfer capacity.

These problems only touch the IMF indirectly but the World Bank with its project financing is directly affected. Due to pressure from US Congressmen the Bank has to produce more reports on the environmental consequences of Bank projects. Pressure from the same source was also put on the Bank to refuse a \$ 500 million credit for the Brazilian electricity company Elektrobras because of its negative effects on the Amazon jungle. The American executive director of the World Bank was, however, outvoted by his colleagues.

It appears, for example, extremely dubious when in the Brazilian iron ore project Carajas the metal is to be melted down in nine forges with the aid of charcoal, which would have to be won from the surrounding tropical rainforest.<sup>39</sup> Dam projects are also under criticism, as they often destroy large areas of tropical rain forest and deprive the natives of these regions of the basis for their existence (e.g. the Tucuruí complex in North Brazil, the Manantali project in Mali, the Narmada dam in India).

It is scandalous that the debt problems of developing countries force them to look for potential earnings in accepting toxic waste from the industrialised countries. A contract with two British firms stipulates that 15 million t of toxic waste is to be delivered to Guinea-Bissau in the next 5 years and that US-\$ 600 m are to be paid for this. That is equivalent to twice the present value

**Table 1**  
**Public and Private Long-Term Debt and Financial Flows in Developing Countries**  
(US \$ billions)

	1981	1982	1983	1984	1985	1986	1987
Disbursements	124.3	116.6	99.1	92.3	88.7	85.7	90.0
Debt Service	89.1	98.7	92.1	99.7	109.5	116.4	119.0
Principal Repayments	47.5	49.7	44.7	46.8	54.8	60.8	64.0
Interest	41.7	48.9	47.2	52.8	54.7	55.6	55.0
Net Transfers	35.2	17.8	7.1	-7.3	-20.8	-30.7	-29.0
Net Transfers to Highly Indebted Countries	18.4	3.9	-7.5	-17.5	-26.1	-24.8	-20.0

Source: World Bank: World Debt Tables 1987-88, Vol. I, pp.xii and xiii.

of foreign debts and twenty-five times the value of the country's annual export earnings. The toxic matter is to be stored, of all places, where the EC is supporting a project for rural development. Serious contamination of soil and water is imminent and fisheries are endangered.<sup>40</sup>

Poverty must be seen as one of the main causes of environmental destruction. Projects to fight poverty thus serve environmental protection. It is therefore to be welcomed that the World Bank intends to grant higher loans to those countries which are prepared to conduct "adequate reforms" in environmental policy. Project loans for the maintenance of forests are to be doubled.<sup>41</sup>

### South-North Resources Transfer

It is a fact that the flow of fresh money to developing countries following the eruption of the international debt crisis in 1982 has come to a standstill and that since then a "perverse" transfer of resources (US Senator Bradley) to the creditor countries has been taking place.

The negative net transfers of all developing countries, defined as the difference between net new debts and interest payments to the creditor countries, reached the sum of \$ 85 billion for 1982-87. (The transfer of investment earnings, e.g. in the form of dividend payments, is not included in this figure.) This compares to a net financial transfer in the five years up to 1982 of \$ 140 billion. Even more serious are the comparative figures for the highly indebted countries: the net inflow in 1978 of \$ 65 billion was followed in 1983-87 by a net outflow of \$ 100 billion.<sup>42</sup>

At the same time total debt has increased. This is due to the fact that the developing countries were not able to meet their debt service obligations fully and were forced to reschedule some of the loans due and to let interest be capitalized. The level of total debt has therefore increased and brings further interest payments in its wake without there having been an inflow of fresh money.

The basic cause of this development is to be found in the sudden reduction in net credit extension to the developing countries since the 1982 crisis of confidence. The reconstruction of this lost confidence via structural reforms in the debtor countries will,

however, probably require a prolonged period of time, if it succeeds at all. Until then the banks will have to continue to grant credit for some of the interest due – at least as long as they "receive more money from the net transfer from the debtor countries than they would if payments were stopped completely".<sup>43</sup> It is therefore to be expected that the net financial transfers to the creditor countries will continue in future.

### Burden of Domestic Mobilisation

This situation is not very auspicious for the debtor countries, for the transfer means a reduction in their claims on the domestic product, whether through the reduction of wages, consumer spending, investment spending or government spending or through the reduction of imports or increasing of exports with the aim of transferring real purchasing power to the receiving country. Reisen<sup>44</sup> must be given credit for having analysed and described the implications of these transfers. One of the most important results of his work, in my opinion, is his recommendation that the developing countries' burden of domestic mobilisation be measured in relation to their tax receipts insofar as the servicing of foreign debts is conducted out of public funds (which can usually be presumed to be the case). The application of this criterium makes the following clear:

□ The burden of domestic mobilisation (as a percentage of government receipts) is exceptionally high. In 1982-84 it was 78.4 % in Argentina, 53.6 % in Brazil and 28.4 % in Mexico.<sup>45</sup> There should be much more public awareness of the fact that the overcoming of the problem of mobilisation requires that domestic loans be cut back by the amount of the transfer!

□ As a result of this there is only a minimum room for manoeuvre left for other government expenditure, even if the calculated values do not reflect the actual absorption of government budgets.

□ The size of the burden explains why the highly indebted countries are not in a position to overcome this burden by taking back their claims to their own domestic product without inflation. The financing of expenditure via central bank loans to the state is only a pseudo solution.

□ All "currency reform" projects are in the last analysis destined to fail as long as the net transfer remains at its present level and government expenditures of a certain size are seen as economically and politically essential. If government expenditures are financed by bonds the real interest rate, which is necessarily high because of

<sup>40</sup> Die Zeit, 3. 6. 1988, p. 24.

<sup>41</sup> Frankfurter Rundschau, 18. 9. 1987, p. 6, and 30. 9. 1987, pp. 1 f.

<sup>42</sup> World Bank: World Debt Tables 1987-88, Vol. I, p. x.

<sup>43</sup> H. Reisen, op. cit., p. 47.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid., p. 111.



the generally pessimistic expectations, leads to an expanding deficit. Such IMF conditions for Brazil made the debt service ratio "literally explode".<sup>46</sup> Thus, there is today a direct causal connection not between inflation and the debt crisis but between transfer obligations and inflation.

□ Because of these facts, confidence in the economic development of the developing countries falls and capital flight is the result.

□ Capital flight increases the need for real devaluation. This makes foreign currency liabilities even more expensive in domestic currency.

For the second of Reisen's criteria, the measurement of the burden of domestic mobilisation as a percentage of gross domestic product, the results are the same: the burden which Latin American debtor countries had to bear in recent years "was heavier than the historical cases of transfer".<sup>47</sup> It is probably without parallel in modern history that a country had to pay up to 10 % of its domestic product to foreign countries for three years running, as was the case for Argentina and Venezuela from 1982 to 1984. In comparison: the reparations which Germany had to pay following the First World War reached, in the worst years from 1929 to 1931, their maximum level of approx. 3.5 %.<sup>48</sup>

The "vicious circle of debt" becomes a "vicious circle of domestic mobilisation": the net transfers made are accompanied by drastic falls in investment ratios, which result in reduced growth rates in the future, i.e. the burden of domestic mobilisation becomes greater. Growing social tensions scare off potential investors and strengthen capital flight.

The above leads us to the following conclusions (which diverge from Reisen's): the IMF's demands appear inappropriate in view of the present situation and the demand that budget deficits be reduced misjudges the room for manoeuvre which the highly indebted countries have in view of the burden which transfers place on the government budget. If government consumption expenditure is decisively reduced, this increases the already existing conflict potential; if its investment expenditure is cut back, this reduces future transfer capacity.

It therefore remains incomprehensible to me, in view of the desolate budgetary situation, how Reisen can regard cutbacks in public expenditure (which would have to be radical due to the size of the transfer burden) as a means of solving the problem of domestic mobilisation.<sup>49</sup> His observation, that without a consolidation of public budgets it is not possible to

implement a payments policy strongly oriented towards price stability, is not to be called into question here, but until now the recommendations following a neoclassical line of argument have ignored the political and social environment in which these market-oriented processes are to take place. There is also no doubt that one of the main causes of public deficits is the deficits of public enterprises and that here in turn the stability and distribution oriented pricing policy represents the most important source of the deficits. Covering these deficits by prices based on costs would, according to Reisen, imply severe losses in real income for precisely the poorest population groups, but accusations aimed at the IMF are barking up the wrong tree: the real responsibility lies in the hands of the debtor countries' governments. Reisen, unfortunately, completely follows the IMF's arguments here. Yet the effects of these basic principles are the reason why the IMF has been exposed to critical cross-fire.

### Southern Burden, Northern Profits

The prices of raw materials have fallen. For the first time in recent economic history the prices of all commodity groups were affected in 1984-86.<sup>50</sup> According to Camdessus we have today reached an historically low level. In real terms prices have fallen to 1930 levels.<sup>51</sup> At the beginning of 1987 real raw materials prices were 40% lower than the maximum level recorded in mid 1984 and 25% below the depression at the end of 1982.<sup>52</sup> The export earnings of the oil exporting developing countries were approx. US \$ 70 billion lower in 1986 than in 1985.<sup>53</sup>

At the same time Latin America's adjustment efforts, for example, were considerable. In 1986 the current value of its imports was 40% lower than the 1981 level and its exports rose between 1980 and 1985 by almost 30%.<sup>54</sup> We can agree with Raffer<sup>55</sup> in seeing this as a result of "unequal exchange":

<sup>46</sup> Ibid., p. 204.

<sup>47</sup> Ibid., p. 113.

<sup>48</sup> A. Frank: Bankrott als Zuflucht, in: Wirtschaftswoche, 20. 11. 1987, p. 90.

<sup>49</sup> H. Reisen, op. cit., pp. 210 f.

<sup>50</sup> World Bank: World Development Report 1987.

<sup>51</sup> M. Camdessus, in: Deutsche Bundesbank: Auszüge aus Presseartikeln, No. 62, 31. 8. 1987, p. 13 and No. 71, 2. 10. 1987, p. 7.

<sup>52</sup> IMF: Annual Report 1987, p. 13.

<sup>53</sup> Deutsche Bundesbank: Entwicklung und Stand der internationalen Verschuldung, in: Bundesbank Monatsbericht, No. 1, 1987, p. 42.

<sup>54</sup> Antonio Ortiz Mena: Zustand und Aussichten der Wirtschaft in Lateinamerika, in: Europa-Archiv, No. 15, 1987, p. 438.

<sup>55</sup> K. Raffer: Unequal Exchange and the Evolution of the World System, London 1987.

□ Peripheral exporters are mainly raw materials exporters. They are very dependent on the opportunity to export raw materials. Demand in the industrial countries is, on the other hand, tending to decline. Cyclical factors, the substitution of synthetically produced raw materials for natural ones, and diminished consumption due to recycling and miniaturisation play a decisive role.

□ Debt service obligations increase the pressure to sell. The debt crisis raises the pressure to increase exports. The pressure on prices is also the result of the IMF's and World Bank's export-oriented strategies. The extension of areas under cash crop production (soya) at the expense of domestic food supplies and improved mining methods (copper) lead to an increase in supply, which is faced with an inelastic demand. Thus Thailand, for example, in 1985 on the recommendation of the IMF increased its rubber exports compared to the previous year by 31%, upon which receipts fell from US \$ 262 million to US \$ 242 million.<sup>56</sup>

□ The exports of the five largest debtor countries are to a large extent sensitive products, i.e. products which are subject to protectionist restrictions in many countries. This diminishes the elasticity of import demand to zero when the quotas allowed are exhausted.

□ The deterioration of the terms of trade additionally exacerbates the debtor countries' problems regarding the domestic mobilisation of resources. The IMF puts the burdens resulting from this at \$ 100 billion for 1986.<sup>57</sup>

□ And finally, there are the protective measures of interest groups within the industrialised countries. For example, after vegetable oils from Asia (Malaysia, Indonesia, the Philippines) became noticeable competitors of the American soya industry, the American Soyabean Association started a \$ 20 million dollar campaign in 1987 with the message, "Eating tropical fats is bad for your health". The EC intends to impose an additional tax of \$ 370 per tonne on the import of coconut oils to protect the grain and fodder trade.<sup>58</sup> The list of such examples can be extended indefinitely.

The profits from these trends on raw materials markets go to the industrialised countries. The collapse of prices has made a considerable increase in their real

income and their standard of living possible and made a decisive contribution to the recovery of their domestic price level stability.<sup>59</sup>

On the other hand they are not prepared to translate this increase in purchasing power into a higher demand for goods from developing countries. For employment policy reasons the markets are increasingly being closed to undesired competition. For the real transfer from the debtor countries to be successful, however, the acceptance of balance of trade deficits by the rest of the world is a *sine qua non*. If this does not take place, the debtor countries' domestic mobilisation and transfer problems will intensify. The industrialised countries in this way themselves devalue the external claims of their banks.<sup>60</sup>

In other words, because the creditor countries' surpluses on the balance of trade make it impossible to solve the debt problem, corresponding valuation adjustments by the banks to their accounts receivable from the debtor countries are necessary.

But no matter how convincing these connections are, it is doubtful whether the necessary exchange of surpluses and deficits between industrialised and developing countries will be realised in the near, or distant, future. Thus the repeated pointing out of South East Asian countries as an example of successful export-oriented adjustment policy is becoming rather aggravating: one need only imagine the distress of the industrialised countries if the "four little tigers" – which as of 1989 are no longer to enjoy the USA's Generalized System of Preferences for developing countries, after having contributed \$ 37 billion (or one fifth) to the US trade deficit – were to become 100 big and little tigers.

It would then be obvious that the IMF's demand for export-oriented allocation policies is inconsistent as long as it does not succeed in committing the industrialised countries to the liberalisation of trade. If liberalisation does not take place, the debtor countries will in future remain incapable of transfers. Then, in turn, the chances will be low that a resumption of net financial transfers to the developing countries will take place. The question remains as to whether such a transfer is in the final analysis meaningful, as it increases future payment commitments so immensely that the growth-cum-debt concept would be put to a hard test.

It therefore appears at present to be absolutely necessary to reduce the developing countries' debt burden obligations in order to put them into a realistic relationship to the productive capacities of their economies. There is no lack of suggestions as to how this could be done.

<sup>56</sup> S. George, op. cit., p. 87.

<sup>57</sup> IMF: Annual Report 1987, p. 2.

<sup>58</sup> Frankfurter Rundschau, 26. 10. 1987.

<sup>59</sup> W. Nöbling: Plädoyer für eine politische Lösung, in: Die Zeit, 27. 3. 1987.

<sup>60</sup> H. Reisen, op. cit., pp. 104, 106.