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Hans W. Singer

BEYOND THE DEBT CRISIS*

Abstract

The effects of the 'lost decade' of the 1980s on the Third World have been devastating — more than is usually realised. It will be an almost impossible task for Third World countries to make up for the losses in the coming decades. In this sense, the 'lost decade' will be with us for a long time to come. The article then speculates about the long-term trends, both favourable and unfavourable, for Third World countries, and expresses some doubts whether the currently predominant neo-liberal counter-revolution will really serve to lay the foundation of future solid and sustainable growth. A more eclectic and country-specific approach is advocated.

I will begin in the time-honoured fashion of economists: 'Let us assume that by general agreement all debts are wiped out tomorrow — 100 per cent. What difference will this make to the world in general and the developing countries in particular?'. If I hear ironic laughter at this assumption as being so out of line with what is possible in the real world, perhaps this is as much a comment on the real world as on my assumption. In the real world, of course, the fact is that with all the hectic efforts of devising new instruments of debt relief, with Baker and Brady plans coming and going, and with all the pre-emption of negotiating time and limited administrative capacities involved, we are back today more or less where we were in 1982 with the volume of debt undiminished. The chief beneficiaries seem to be the commercial banks and that mysterious entity the 'world financial system' which has been protected and safeguarded, rather than the developing countries.

The first thing to realise is the tremendous devastation which the nine years of the debt crisis (dating it from the Mexican moratorium in 1982) have wrought upon the developing countries. Compared with the GDP growth rate of 1965-80, the developing countries have lost during the past decade cumulatively income as follows: low-income countries other than China and India 35% of GDP; lower-middle-income countries 39%, upper-middle-income countries 23%; sub-Saharan Africa 40%; Latin American and Caribbean 45%; the severely indebted countries also 45%. These would be the jumps in income required to bring the Third World back to the 1965-80 line. In manufacturing — which I still consider the flagship of economic development — the cumulative setbacks have been even more severe: 32% for the low-income countries other than India and China; 53% for the lower-middle-income countries; no less than 85% for sub-Saharan Africa; 57% for Latin America and the Caribbean. Only the upper-middle-income countries managed to keep this cumulative loss to a relatively modest level of 10%.

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Not all of this economic devastation (compared with 1965-80) is due to the debt crisis. The industrialised OECD countries have also had their setbacks but with a cumulative setback of 7% for GDP and only 4% for manufacturing these setbacks seem minimal compared with those of the Third World and could easily be made up in the next ten years by better economic management on behalf of the G7 and by restoring the growth objective to a more equal place relative to control of inflation — more of Keynes and less of Milton Friedman!

By contrast, to return the Third World countries during the next decade back to the 1965-80 line, so as to make up for the cumulative loss during the 80s, would require nothing less than a miracle. GDP of low-income countries would have to grow by 8.5% per annum; lower-middle-income countries by 9.4% per annum; upper-middle-income countries by 7.9% per annum; sub-Saharan Africa by 8.8% per annum; Latin America and the Caribbean by 10.5% per annum. In other words, the task is impossible (except perhaps for the upper-middle-income countries) and if ever at any point in the future we are to get back to the interrupted 1965-80 line, it will take very much longer than a decade. The job may have to be spread out over 30-40 years at least. So we will be walking in the shadow of the debt crisis for a generation or more, even if the debts are wiped out tomorrow. It will be a long run and 'in the long run we are all dead'. In spite of the much-vaunted 'outward orientation' achieved during the 1980s, it is true, even in the case of trade, that arrears have to be made up. The rate of growth of exports of low-income countries other than China and India fell from 5.9% per annum in 1965-80 to 0.5% in 1980-88; their exports would have to increase by no less than 11.3% per annum to come back again to the 1965-80 growth line. For sub-Saharan Africa the figures are even worse. In the case of the lower middle income countries, the impact of outward orientation on export volume has been minimal, from growth at 5.8% in 1965-80 to 6.0% in 1980-88. It is only in the case of upper middle income countries and of Latin America that there has been a visible shift to outward orientation reflected in the volume of exports. And these figures relate to the *volume* of exports and do not therefore reflect the deterioration of terms of trade which has occurred not only for the primary commodity exports but also for the manufactured exports of developing countries.[1] Nor does it show the import strangulation — directly related to the cuts in investment already noted. Imports of low income countries other than China and India have fallen at the rate of 3.2% in the recent decade after rising by 4.5% per annum 1965-80. They would have to rise by no less than 12.2% per annum in the next decade to make up for this shortfall. For the severely indebted countries as a whole, as well as for Latin America and the Caribbean and for sub-Saharan Africa, this downward shift and shortfall is even greater. It is noteworthy that, while the OECD members also showed a drop in their growth of exports (some of it explained by the import strangulation in developing countries), they were able to increase the growth rate in the volume of their imports (from 4.2% to 5.1%), largely due to their improved terms of trade — the counterpart of the deteriorated terms of trade of Third World countries.

As against this, the neo-liberal counter-revolutionaries which today control some of the strategic positions in the development institutions will argue that this is a false calculation based on excessively static assumptions. Many of the developing countries have improved the quality of their policies through structural adjustment programmes and thus 'laid the foundations for subsequent sustainable growth', in the favourite phrase of this school. In this picture of the world, the past decade was a period of necessary consolidation, of reculer pour mieux sauter. Perhaps so — only the future can tell. If this view is correct, and if the Third World countries are really in better shape now for subsequent growth, then perhaps catching up with the 1965-80 line is not impossible, at least gradually in the course of time.

But there is also the opposite view, i.e. that what has happened in the past decade, far from 'laying the foundations of subsequent growth' has done exactly the opposite, i.e. that it has *destroyed* the foundations for subsequent growth. This view can find support from the particularly heavy decline of investment in the indebted countries and Third World countries generally. Investment has declined even more than GNP, i.e. it has declined as a proportion of GNP. I know that physical capital investment is not the only — perhaps not the major — source of growth, but I am old-fashioned enough still to think that it is an important determinant of future growth. Gross domestic investment in the severely indebted countries, after growing by 8.4% per annum in 1965-80, has over the past decade *declined* by 3.1% per annum. This is a swing, in the direction of decline, of 11.5% or no less than 115% cumulatively over the decade. This means that the volume of investment in these countries over the next decade would have to be more than double that of the last decade in order to bring them back to the 1965-80 line. The corresponding figures for sub-Saharan Africa and for Latin America are equally bad or worse. Thus I think there is another scenario, at least as plausible as that of 'laying the foundations of subsequent growth'. That is the scenario, first introduced into development economics by Gunnar Myrdal, of cumulative processes and vicious circles leading countries into a poverty trap.

In any case, scepticism about our having 'laid the foundations of subsequent growth' does not depend on belief in physical capital investment, Harrod-Domar, ICOR and all that. The picture is no different if we talk about human capital. Central government expenditure on education has fallen from 20.5% to 9.0% in low-income countries; from 17.5% to 13.3% in lower-middle-income countries; from 15.4% to 11.0% in Latin America and the Caribbean; and from 15.6% to 10.8% in the severely indebted countries. There are similar declines in health expenditures as a proportion of government expenditure from 5.5% to 2.8% in low-income countries; 5.7% to 4.0% in lower-middle- income countries and from 5.9% to 4.4% in the severely indebted countries. Again it will take many years before such a cumulative shortfall can be made up. All this does not look like laying the foundations for growth in terms of the human resource basis.

So there is some reason to be sceptical about the view that the Third World economies are now 'leaner and fitter' to face the world ahead beyond the debt crisis. They are certainly leaner but whether they are fitter remains to be seen. Probably true in the case of much of Asia, probably untrue in the case of Africa, Latin America, and the Middle East.

But it seems not very useful to dream in terms of a return to paradise lost. Nor is it very productive to sit down wearing sackcloth and sprinkling ashes on our heads, wailing in doom and gloom. Far better to accept the setbacks of the 'lost decade' as water under the bridge and ask ourselves: Where do we go from here? How can we do better in the future?

Economic projections are notoriously tricky and our record as forecasters is very patchy to say the least. The World Bank projections, whether on commodity prices, growth rates or results of structural adjustment programmes, have proved chronically over- optimistic and had to be repeatedly revised downward. As a result the World Bank, and all of us, have become more humble about our projections and hedge them with careful assumptions. As somebody has said: 'There is nothing wrong with making projections as long as you leave the future out of it.' (sounds like Galbraith to me). There is practically no area, from the 'peace dividend', financial flows, the Uruguay round, oil prices, future technologies, etc where you could not make plausible optimistic assumptions about the impact on developing countries or equally plausible pessimistic assumptions. So I am taking my courage in both hands in making the following propositions:

1. The international context for the growth of developing countries will continue to be unfavourable. The growth rate of industrial countries is expected to continue to be sluggish even if recessions can be avoided. The surplus countries in particular seem determined to put the objective of inflation control above that of more rapid growth and fuller employment. The job of global economic coordination, now largely in the hands of the G7, is clearly not properly done — see their recent meeting this April when it was clear that each country acted by its own domestic lights, without much thought for the impact on other countries, least of all the Third World. Professional economists can talk themselves hoarse to explain that all could benefit if externalities, in the form of impact on the rest of the world with feedback effects on the acting country itself, were properly taken into account. The point seems to get lost in the G7 and its bland communiqués. It would be rash to expect the 'locomotive of growth' which the industrial countries are to provide for the rest of the world to move very fast in the next decade.

2. We are gradually learning to be more humble, not only about projections in general, but also about the right kind of development policies, about what works or does not work. At one time we believed in planning and the government as the guardian of the public good. More recently, we believed in privatisation, free markets and the invisible hand. We are now swinging back to a more moderate position between these two ideological extremes, in the form of a belief in 'good governance' which each of us is then free to interpret as we think best. As a result, domestic development policies could become more pragmatic with mixtures of planning, free markets and experiments with 'social market' systems. This may make development policies much more diverse and trendless, certainly more so than the broadly uniform and identical policies imposed under debt pressure by the Bretton Woods institutions on developing countries today. (Remember that we have assumed elimination of debts and hence reduced leverage and reduced outside pressure on developing countries.) This is already foreshadowed in current World Bank projections where the main line of hedging now runs as follows: prospects for developing countries are much less determined by the international context than by their domestic policies, but developing countries differ sharply in the quality of their domestic policies (in 'good governance'); hence their future growth rates will differ sharply, and average growth rates are difficult to predict as well as not particularly meaningful. We may note that this type of projection tends to be self-fulfilling, i.e. if average projected growth rates

turn out to be too high it follows that the governance of developing countries has been less than good. This hedge also depends on the assumption that the international context is less important than domestic policies — a proposition on which one can differ and which would be difficult to quantify.

3. On financial flows it is difficult to be optimistic. If there is full debt relief one can hardly see private investment and commercial bank lending resuming with any vigour. Official development assistance will have to provide the bulk of resources. Yet this assistance has stubbornly refused to rise above even half the theoretically accepted level of 0.7% of GNP. Eastern Europe and Russia will be big competitors for financial assistance. The Gulf, from being a major source of outward capital flows to developing countries, may well absorb resources rather than provide them. The air is presently thick with assurances that aid to Eastern Europe, the Gulf, to domestic social sectors, etc. will not be at the expense of developing countries, but I would not be willing to bet too confidently on this. Furthermore, if the above assumption about sluggish growth in industrial countries for the sake of inflation control is correct, this may mean rising unemployment; and this in turn may mean that financial resources are domestically absorbed to cope with social problems and unemployment since 'charity begins at home'.

4. Technology may work as much against developing countries as in their favour. True that biotechnology, improved health technology, globalisation of production due to improved communications technology, etc. may work in their favour. But increased replacement of natural raw materials, increased importance of high skills rather than cheap labour, closer integration of R & D with production will operate against them. Nobody can be sure today where the balance will lie. In this area it may be true to say that countries with good technology policies could gain by maximising the advantages and minimising the disadvantages, and vice versa.

I hope that we will all meet in good health in ten years' time, at the 25th SID World Conference, and will then be able to say that in the 1990s we have put the 'lost decade' of the 80s behind us.

NOTE

1 See P. Sarkar and H. W. Singer, 'Manufactured Exports of Developing Countries and their Terms of Trade since 1965' in *World Development*, April 1991.

Hans W. Singer, The Institute of Development Studies at the University of Sussex, Brighton BN1 9RE England