# Third World External Debt in the Light of Simple Economics*

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India and other third world countries can morally justify their being a part of G-20 alongside the imperialist powers, only if they raise common and pressing problems of the third world as a whole at G-20 meetings. Perhaps the most pressing of such problems today is the problem of external debt, which the current crisis of neo-liberal capitalism has brought to the forefront. India, as the chairman and host of the next G-20 meet, must raise the issue of relief from external debt for the third world at this meet. Much confusion however prevails on this issue which an excursus into simple economics should clarify. Let us see how.

A common perception of third world external debt is that the advanced capitalist countries have foregone their domestic consumption or investment to spare the resources that they have lent. True, the debt incurred by third world countries is to financial institutions, but such borrowing covers current account deficits of these countries; any borrowing in excess of the current account deficits would simply be added to their foreign exchange reserves, and hence would not constitute net borrowing. Of course, if there is a certain net borrowing to finance a deficit in a particular year, then even if the deficit disappears subsequently, the net borrowing amount will keep growing because of compound interest being charged on it. But all primary net borrowing must be to obtain resources to cover current account deficits. And the lending of such resources represents a sacrifice on the part of the lending countries, which therefore requires that they must be paid back at a later date for the sacrifice they made.

Even simple economics shows however that this entire perception is completely wrong. When there is a reduction in demand relative to supply for any good, three kinds of adjustment are possible: its price may fall; more inventories of the good may be held; or its output may fall. Now, in manufactured goods (and services) the prices are generally fixed by oligopolistic producers and do not fall (except perhaps as a deliberate brief manoeuvre); likewise, inventory build-ups are quickly liquidated, so that larger inventories are not held for long. A fall in demand therefore leads to a curtailment of output. And taking the economy as a whole, that is all goods together (if these are generally manufactured goods and services, as is the case with advanced capitalist countries), the observed output at any time is what it is because the demand for it is neither more nor less. And that is why capitalism is a demand-constrained system: output and employment cannot be increased under capitalism in any given period because there is not enough aggregate demand.

Now the current deficits of third world countries vis-à-vis the metropolitan countries, are nothing else but the latter's current surplus, which is a component of aggregate demand. If this surplus did not exist, then that much output would not be produced. The real goods and services that the third world countries borrow from the metropolis therefore materialise precisely because of such borrowing. There is no question of the metropolitan economies making any sacrifices, by curtailing their domestic consumption or investment, while giving loans to the third world.

But that is not all. Suppose 100 dollars constitute the current surplus of the metropolis vis-à-vis the third world, which are lent by the latter. These 100 dollars constitute additional savings of the metropolis over and above what finance the metropolis' domestic investment. If the savings ratio (that is savings divided by national income) of the metropolis is 25 per cent, then to generate these extra savings of 100 dollars, income has to rise by 400 dollars, which means that consumption in the metropolis must rise by 300 dollars (i.e. 400-100 dollars). The loan made by the metropolis therefore, far from constituting a sacrifice of consumption, gives rise to additional consumption that is three times the amount of the loan. The metropolis makes no sacrifices in making a loan to the third world; on the contrary its domestic consumption increases because of the loan which it would not have done without the loan. Its total output (income) increases by an amount equal to the sum of the increase in consumption and the loan it makes, and so does its employment to a corresponding extent. The loan in short has a "multiplier" effect on the total income of the metropolis, which, if the savings ratio is 25 per cent, has a value of 4 (the multiplier in short is the reciprocal of the savings ratio).

All this is simple economics. (Even school textbooks used to teach all this though I do not know if the BJP government, given its penchant for unwisdom, still retains it). What it means is that even if the entire third world debt owed to the metropolis is written off, the metropolis would be no worse off relative to the situation before it made the loan, and would in fact be better off because of the increased consumption and employment.

Precisely because of this implication of giving a loan, the simple economics underlying it is sought to be camouflaged by the Bretton Woods institutions, by metropolitan financial interests, and by an economics profession that has turned its discipline into what Marx would have called "vulgar economics". They not only propound a "sacrifice" narrative with regard to real resources (as if capitalist economies are invariably supply-constrained), but even invent a scarcity of financial resources which states that the amount of funds available for making loans is limited at any time!

John Maynard Keynes, the well-known English economist, had made a remark that had appeared odd at first sight during the Great Depression, namely, that if workers were employed in public works projects simply to dig up holes in the ground and then fill them up, society would still be better off. If 100 dollars were spent on such "utterly useless" projects, they would still generate 300 dollars of additional consumption (and an amount of corresponding additional employment), which would constitute a better social situation. The 100 dollars of loan to the third world being written off would be exactly like 100 dollars being spent on digging holes in the ground and filling them up; the metropolis would still be better off.

This incidentally was the thinking behind the Brandt Commission recommendation that the advanced countries should earmark 1 per cent of their GDP every year as grants to the less developed countries. Doing so would not harm the advanced countries one iota since they operate demand-constrained systems; on the contrary, it would benefit those societies even in narrowly economic terms by the "multiplier effects" of such grants.

So far we have looked upon third world external debt as if it is owed only to the metropolitan economies. This clearly is not true. There is some debt owed to China and also, usually indirectly, that is mediated through metropolitan banks, to the oil-producing economies; the above discussion is not relevant for such lenders, since neither China nor any oil producing economy can be considered demand-constrained, as the manufacturing economies of the metropolis are. It follows that the indebted third world countries must make separate arrangements with these lending countries, both to develop a direct relationship with them unmediated through metropolitan financial institutions, and to obtain debt relief. With metropolitan dominance over the world economy weakening, the possibility for making such separate arrangements is much greater today.

With regard to the metropolitan economies however, since the typical belief that they have made a “sacrifice” in giving loans to the third world countries is invalid, the latter should set terms for debt-servicing that suit their own economic needs rather than being bound by IMF-mediated “rescue packages”. Such “packages” basically protect the interests of the lenders by compressing living standards and, hence demand, in the borrowing economies, in order to squeeze out resources for debt-servicing.

Of course no single borrowing country would have the strength to take on the metropolitan economies and set its own terms for debt repayment and interest payments; but, as a collective, the borrowing countries can. They can for instance insist that instead of meeting debt-servicing deadlines, they should be allowed to earmark only a certain proportion of their export earnings each year towards this purpose, as Alan Garcia the former Peruvian president had once done for his economy; and that the debt amount itself should be scaled down sufficiently.

All this requires prior discussions among the debtors, followed by negotiations between the debtors and creditors. Countries like India that are members of the G-20 should take the initiative for arranging such negotiations.

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