When export prices fall, the Government may run a deficit and in order to maintain the domestic price for exports and simultaneously be subjected to balance-of-payments pressure as export earnings decline and imports remain undiminished.

In an effort to avoid serious balance-of-payment problems, primary producers have tended to maintain strict control over imports. Primary producing countries have endeavored to keep imports for consumption down, but with only limited success. Reduction of imports of fuels and industrial raw materials may cut the current output of the economy. The only major category left is capital goods. Thus, the principal impact of fluctuations in imports has been on the investment sector through cuts in capital goods imports.

If domestic incomes change with the volume and price of exports, then the incentive to invest in the private sector may be weakened and the demand for imported capital goods may decline. If, however, the Government maintains domestic incomes, the demand of the private sector remains unaffected. In addition, in most less developed countries public investment is a significant portion of total investment, and governments are reluctant to cut capital goods imports when doing so may impair their development program. Balance-of-payments difficulties may ensue if import demand is sustained, but development suffers if imports are reduced to match reductions in exchange earnings.[2]

Instability in exchange earnings, and hence in supplies of imported capital goods, makes it difficult to formulate and implement development programs in less developed countries. Investment activities are interrelated, so that a balanced growth of the economy may not be achieved unless various investment projects are completed in the appropriate time-phased fashion. Programing, of course, has elements of flexibility built into it so that some delays may be absorbed with relatively little harm. However, the fluctuations in exchange earnings experienced by many less developed countries are beyond their ability to absorb without harmful consequences for economic development.

The uncertainty introduced by instability affects private as well as public investment. Private investors are often disinclined to make longrun capital investments for fear they might not be completed or that costly delays may occur. Because of instability many private interests in less developed countries prefer short-term commercial investments to more basic investments in industry and agriculture. Instability may also interfere with important public services such as health, welfare, and educational programs. Since in many less developed countries governmental revenues depend heavily upon import and export taxes, instability may result in limiting important public functions.

There are also important consequences for industrial trading partners of countries whose export earnings are unstable. Instability impels less developed countries to maintain severe import controls and to substitute domestic production for imports whenever possible, even if domestic substitutes can only be produced at a very high cost relative to the cost of imports. Thus, instability acts in many instances

[2] "The Quest for a Stabilization Policy in Primary Producing Countries: A Symposium," Kyklos, vol. XI, fasc. 2, 1958, pp. 139–265, and "Stabilization and Development of Primary Producing Countries: Symposium II," Kyklos, vol. XII, fasc. 3, 1959, pp. 269–401, examines in detail the internal policy problems of less developed countries.