Department of Economic and Social Affairs

THE FINANCING OF ECONOMIC DEVELOPMENT

World Economic Survey 1965 – Part I

UNITED NATIONS
New York, 1966

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

E/4187/Rev.1
ST/ECA/91

UNITED NATIONS PUBLICATION

Sales No.: 66. II.C. 1

Price: $U.S. 2.50
(or equivalent in other currencies)

FOREWORD

This report, *World Economic Survey, 1965*, is the eighteenth in a series of comprehensive reviews of world economic conditions published by the United Nations. It is issued in response to General Assembly resolution 118 (II), in which the Secretary-General was requested to prepare an annual review and analysis of world economic conditions and trends. The report is intended to meet the requirements of the Economic and Social Council and other organs of the United Nations for an appraisal of world economic conditions which may serve as a basis for recommendations in the economic field. It is also intended to stimulate interest in and discussion of international economic problems among a more general public audience.

Each year since 1955, the *World Economic Survey* has contained a study of a particular problem in the field of economic development. Among the subjects examined have been economic growth in the first post-war decade, balance of payments problems in relation to economic growth, inflation, post-war commodity trade and policies, experience and policies relating to investment and saving, industrialization and economic development, foreign trade and economic development and the appraisal of development plans.

The present *Survey* deals with a problem that has been a matter of long-standing concern in various United Nations bodies, namely the financing of economic development. The focus of this concern in recent years has been the slow progress towards the targets of the Development Decade. If growth rates are to be accelerated, more resources will have to be devoted to investment, and the twin tasks of raising saving levels in low-income countries and generating an adequate volume of external purchasing power in countries most of whose exports face a relatively unresponsive demand pose a formidable challenge. Considerable importance therefore attaches to the flow of resources to the developing countries in the form of loans and grants from the rest of the world.

Chapter I discusses the problem of increasing the volume of savings available to the developing countries. Trends in the period 1953-1955 to 1962-1964 are reviewed and the sources of saving are examined, distinguishing in particular between domestic and foreign, between government and private, and between corporate and household. The strategic importance of foreign saving is emphasized, and the next three chapters take up the various aspects of international resource transfer that is implied in foreign saving. Chapters II and III examine the volume and form of transfers from the developed market economies, pointing out the increased involvement of governments and the growth of transfers in kind. There is a discussion of the tying of loans and its consequences and a discussion of the terms of lending, in the light of the mounting burden that the servicing of debt entails. Chapter IV reviews the nature and source of transfers from the centrally planned economies and comments on some of the ideas now being formulated for rationalizing the lending and repaying arrangements with the developing countries. Chapter V traces the history of the international interest in the transfer of resources to the developing countries both at the operational level through multilateral agencies and at the level of policy formulation. The five chapters are preceded by an introduction which provides a summary and a perspective.

Part II of the *Survey*, which is issued as a separate volume, deals with the salient features of the world economic situation. It covers the events of 1965 and early 1966 and summarizes the principal developments in four sections—world production and trade, recent trends in the developed market economies, the developing countries and the centrally planned countries—and forty-two tables. It incorporates information provided by governments in response to the Secretary-General's questionnaire on economic trends, problems and policies circulated in December 1965.

The *World Economic Survey* is prepared in the Centre for Development Planning, Projections and Policies of the Department of Economic and Social Affairs of the United Nations Secretariat.

EXPLANATORY NOTES

The following symbols have been used in the tables throughout the report:

Three dots (. . .) indicate that data are not available or are not separately reported

A dash (—) indicates that the amount is nil or negligible

A blank in a table indicates that the item is not applicable

A minus sign (-) indicates a deficit or decrease, except as indicated

A full stop (.) is used to indicate decimals

A comma (,) is used to distinguish thousands and millions

A slash (/) indicates a crop year or financial year, e.g., 1960/61

Use of a hyphen (-) between dates representing years, e.g., 1961-1963, signifies the full period involved, including the beginning and end years.

Reference to "tons" indicates metric tons, and to "dollars" United States dollars, unless otherwise stated.

The term "billion" signifies a thousand million.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals, because of rounding.

The following abbreviations have been used:

ADELA	Atlantic Community Development Group for Latin America
AID	Agency for International Development [United States of America]
CMEA	Council for Mutual Economic Assistance
DAC	Development Assistance Committee [OECD]
EACSO	East African Common Services Organization
EDF	European Development Fund
EEC	European Economic Community
EIB	European Investment Bank
ERP	European Recovery Programme
GATT	General Agreement on Tariffs and Trade
IBRD	International Bank for Reconstruction and Development
ICA	International Co-operation Administration
IDA	International Development Association
IDB	Inter-American Development Bank

IFC	International Finance Corporation
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
UNCTAD	United Nations Conference on Trade and Development
UNEPTA	United Nations Expanded Programme of Technical Assistance
UNFC	United Nations Fund for the Congo
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
UNKRA	United Nations Korean Reconstruction Agency
UNRRA	United Nations Relief and Rehabilitation Administration
UNRWA	United Nations Relief and Works Agency
UNSF	United Nations Special Fund
UNTA	United Nations Technical Assistance
WFP	World Food Programme

"Rhodesia and Nyasaland" stands for the former Federation of Rhodesia and Nyasaland; "Tanzania", for the United Republic of Tanzania. Where statistical presentation has rendered it necessary, the term "Federation of Malaya" has been used to indicate that data refer only to those parts of Malaysia formerly so designated; "South Africa" has been used to designate the Republic of South Africa, South West Africa and the High Commission territories of Basutoland, Bechuanaland and Swaziland.

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country or territory or of its authorities, or concerning the delimitation of its frontiers.

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SUMMARY AND CONCLUSIONS

The problems faced by the developing countries in financing their economic growth may be very simply stated. In order to increase the volume of goods and services available to its population, a developing country has to expand its productive capacity. This means devoting more of its resources to capital formation and adjusting its level of consumption accordingly. Increasing the rate of investment in an economy with a relatively low degree of industrialization involves ensuring both the necessary level of saving and the necessary volume of foreign exchange for importing the required plant and equipment. It also entails the provision of the necessary volume and assortment of other resources, including human skills, to complement the available capital. And in all three respects serious obstacles have to be overcome.

As far as increasing domestic savings is concerned, the principal obstacle lies in the poverty which is characteristic of most developing countries: the lower the level of personal income the higher is the proportion pre-empted for the essentials of subsistence and the more difficult it is to squeeze consumption in order to release resources for capital formation. Even when such squeezing is effected, it is not always easy to channel the resultant savings to the sectors and in the form in which they can be used for purposes of development. The problem of resource creation and deployment thus entails institutional innovation both in respect of the elaboration and use of fiscal machinery for stimulating saving and for the raising and investment of public revenue and in respect of the organization and operation of a capital market for channelling savings into productive use in the private sector.

As far as external savings are concerned, the question is chiefly one of expanding the volume so as to supplement, to the maximum extent possible, the resources made available domestically. But the forms in which external savings are provided have become increasingly diverse, and this has posed additional questions, not only for the recipient country but also for those—usually more developed countries—that furnish the resources. The traditional channels for the international movement of capital—direct private investment and the floatation of bonds by public authorities—have proved quite inadequate for the transfers of resources to the developing countries. Governments have become increasingly involved, and to deal with the various components—equipment, skill and knowledge as well as financial capital—usually lumped together in a single package in direct investment, there has been a proliferation of institutions, national, regional and global.

As, in the years that followed the Second World War, governments in the more advanced countries came to accept responsibility for organizing and fostering the transfer of resources to the developing countries, they began to experiment not only with the mechanisms for achieving this but also with the form of the resources themselves, seeking to minimize the ratio of real cost to potential benefit. This has involved the exercise of stricter control over the source or physical nature of the assets transferred. The resultant increase in the extent of "tying" in its various forms has posed utilization problems for the recipient countries trying to integrate external savings and domestic savings within the framework of their development plans.

Though, on the average, the terms on which these transfers have been made have tended to ease, much of each year's total flow—and, in the most recent period, an increasing proportion—has continued to be repayable and subject in varying degree to an interest charge. As a result, there has been a very rapid rise in the outstanding external debt of the developing countries and a corresponding increase in the cost of servicing it. This servicing obligation pre-empts a growing volume of foreign currency and, in the face of a rather sluggish growth in export earnings, the burden of debt service has become rapidly heavier. In order to maintain the net level of inflow, therefore, a steadily increasing volume of gross transfer is required. In fact, however, the flow of new loans, grants and investments from the more advanced countries, after rising rapidly in the second half of the nineteen fifties, has levelled off since 1961. Notwithstanding the adoption of a target in 1960 linking the net outflow of resources from the developed market economies to their national income, actual transfers to the developing countries have failed to keep up with the growth of production in the more advanced countries. Indeed, if allowance is made for reverse flows (of interest and profit and of indigenous capital) and for the fact that a large proportion of receipts consists of transfers in kind (much in the form of designated "surplus" commodities) or of reinvested profits earned in the developing countries themselves, it is evident that the amount of new, external, disposable purchasing power being made available to the developing countries has declined to a very low level.

As a result of these recent changes in the composition and magnitude of the net flow, the relative contribution of external savings to investment in the developing countries, which had been expanding, has contracted quite sharply. And largely as a consequence of this, the rate of gross capital formation in the developing countries has failed to increase in line with the Development Decade objective of accelerating over-all economic growth.

And finally there is the problem of ensuring an appropriate expansion in the supply of complementary factors of production. In many developing countries this is the most serious of the gaps, partly because it is in fact a composite of many gaps—including resource deficiencies of all types—and partly because among those shortcomings are some of the most recalcitrant and enduring. To some extent this resource gap can also be filled by means of transfers from abroad: technical assistance and food aid are specifically intended to make good recognized deficiencies in the resource pattern of individual developing countries, and direct investment involves the transfer of an appropriately balanced bundle of resources for the operation of a viable enterprise. But in so far as the gap reflects the unsuitability or inadequacy of particular cultural or institutional arrangements or of strategic natural resources, it may be extremely difficult to bridge it rapidly.

This *Survey* does not deal with the difficulties of overcoming deficiencies in the factors that complement the supply of capital in the production process. Such deficiencies are often particularly awkward in that they tend to inhibit the growth of savings and investment while at the same time responding only slowly to the impact of such capital formation as is achieved. To interpret realistically the role that capital formation plays in promoting economic development, therefore, these deficiencies should not be allowed to slip too far into the background. They determine to a large extent the capacity of a country to save, and they influence the criteria by which the appropriateness of the composition of the inflow of external resources needs to be judged.

RECENT TRENDS IN SAVING AND INVESTMENT

Decisions and policies relating to saving and investment are necessarily made at the national, local or enterprise level, and the conditions influencing them differ widely from country to country. An examination of recent experience of particular countries in financing their development programmes shows that such essentially individual characteristics as natural resources, population, income level and distribution, export structure and historical and institutional links with capital markets are among the principal determinants of the course and modalities of investment. Notwithstanding the diversity that this implies, the available statistical evidence suggests a widespread improvement in saving rates in the post-war period. In the ten years ending in 1964, approximately three out of four of the developing countries registered an increase in the ratio of gross saving to gross production. The gain was made during the nineteen fifties and it came chiefly from abroad—in the form of foreign savings to finance the widening trade gap. During the nineteen sixties, so far, the improvement in saving rates has not been maintained (*see* figure I).

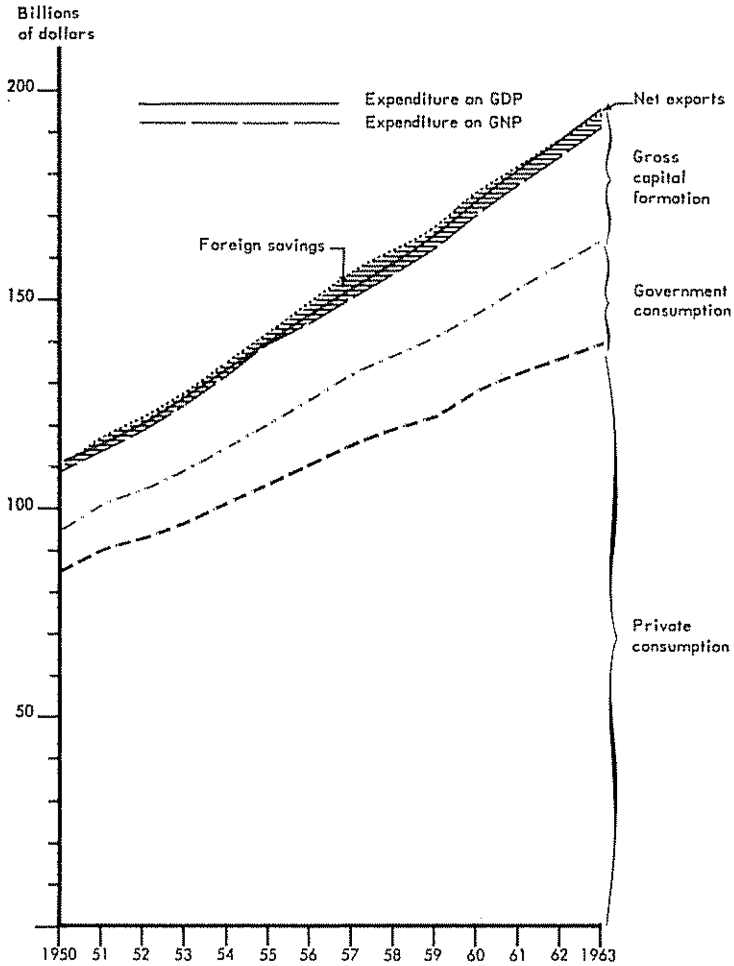
In 1965—half way through the Development Decade—the total output of goods and services in the developing countries was of the order of $240 billion.[1] In real terms it had increased relatively slowly in the first three years of the Decade and more rapidly in the next two. The average rate of growth during the period was somewhat below the rate recorded in the nineteen fifties, notwithstanding the acceleration that had occurred in the rate of increase in population. Of major significance in this connexion was the falling off in the rate of increase in gross fixed capital formation: this had averaged in excess of 6 per cent a year in real terms in the nineteen fifties, but was down below 4 per cent in 1960-1963.

The fact that in the early years of the Development Decade investment increased at a lower rate than production is not attributable to a lag in domestic saving. This was rising by almost 6 per cent a year, to almost 14 per cent of gross domestic product in 1964. The lag in investment reflects the slackening in the inflow of capital from abroad and the resultant inability of the developing countries to finance trade deficits on the scale on which they had been incurred in the second half of the nineteen fifties. These deficits had left many of the developing countries with a large and expanding volume of external debt and a liquidity strain of crisis intensity. Accentuating the slackening in the inflow of foreign capital was a rapid rise—averaging about 10 per cent a year, almost double the rate registered in the nineteen fifties—in the net outflow of interest and profit: by 1964 this was absorbing more than half of the net inflow of grants and loans, and its increase reflects both the interest burden of the growing debt and the rise in dividends in the wake of the expansion in earnings by foreign-owned export industries.

[1] In this *Survey*, the developing countries are defined as all the countries and territories of Latin America and the Caribbean area, Africa (other than South Africa) and Asia (other than mainland China, Cyprus, Japan, Mongolia, North Korea, North Viet-Nam and Turkey).

Figure I. Developing countries:[a] Growth of consumption, capital formation and foreign savings, 1950-1963

(Billions of dollars at 1960 prices and exchange rates[b])



Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Yearbook of National Accounts Statistics, 1965* (Sales No.: 66.XVII.2)

[a] Latin America, Africa (other than South Africa) and Asia (other than mainland China, Cyprus, Japan, North Korea, North Viet-Nam and Turkey).

[b] Official exchange rates, except in the case of countries with multiple rates where effective implicit rates were used.

The effect of the reduction in foreign savings was enhanced by the need felt by many developing countries to rebuild their depleted foreign exchange reserves. In the aggregate, these were replenished to the extent of about $2 billion between 1961 and 1965.

The relationship which investment bears to output has differed widely from year to year and from one developing country to another, depending on the pattern of investment as well as the composition of production especially where a variable agricultural yield bulks large in the total. Over a period, however, most developing countries fall within a fairly narrow range: on the average in the past ten years it has taken between $3 and $4 billion of new investment to yield a $1 billion increment in gross annual output.

It is clear that if the rate of growth in total production is to be accelerated to permit all developing countries to attain the target set for the end of the Development Decade, a substantial increase in investment will be required. This will call for a further rise in the rate of domestic saving and a considerable expansion in the capacity of the developing countries to import. The latter depends upon the growth of foreign exchange receipts, chiefly from exports but also from loans and grants, due allowance being made for the amount pre-empted by net factor payments and for some outflow of indigenous capital. The effectiveness of the net inflow of capital depends, in turn, not only on its nominal magnitude but also on its form, particularly on its liquidity or on the extent to which it helps to meet various strategic requirements—technical skills and food, for example.

Implicit in this last point is the caveat entered in the previous section, namely, that the bridging of any projected gaps in savings and foreign exchange, in a purely arithmetic sense, will not of itself ensure a higher sustainable growth rate. The need for making good other deficiencies is most obvious in the case of countries in which the production of the traditional rural sector bulks large in total national output. The forces inhibiting a rapid rise in productivity in that sector clearly transcend the shortage of capital: they impinge on all facets of social organization, including those of custom, attitude and belief which have a notoriously high resistance to change.

Some lessons from recent experience

The record of financing economic development in the post-war period has demonstrated the quantitative importance of domestic savings and the strategic importance of external savings. Acceleration of growth rates cannot be achieved without an increase in saving rates in the developing countries. But such an increase can be effective only if it is complemented by an adequate supply of external purchasing power. In many of the developing countries, export structures do not provide an assured source of expanding foreign currency earnings; hence there is a certain dependence on the net inflow of resources other than through trade. This has made the financing of economic development an international matter, involving the governments of the more advanced countries as well as those of the developing countries themselves.

PROBLEMS IN THE DEVELOPING COUNTRIES

Although, as indicated above, the first half of the nineteen sixties has seen the domestic savings of the developing countries rise more rapidly than the net supply of foreign savings made available to them by the rest of the world, this was more the result of the slackening of the latter than of any marked acceleration in the former. Domestic saving rates have been creeping upwards but it has taken almost ten years to raise the average by about one per cent of total production. At less than 14 per cent of gross domestic product, the average gross domestic saving rate still lags well below the 15-20 per cent that would be required to sustain an annual rate of growth of 5 per cent on the basis of the average incremental capital-output ratios recorded in those ten years.

To some extent the slow improvement that has taken place in the rate of domestic saving reflects rising levels of output but, with *per capita* incomes in most developing countries still very low by international standards, the gain could not have been made without the necessary expansion in foreign exchange receipts from trade and incoming capital. Nor could it have been made in the absence of various changes affecting domestic institutions as well as policies. Indeed, the challenge lying immediately ahead is to raise the saving propensities at given income levels by the provision of an appropriate combination of incentives and institutional facilities. Though the shape and dimensions of the problem vary considerably from one country to another, and the impact of exogenous factors is likely to continue to differ widely, the experience of recent years suggests that the effectiveness of savings mobilization depends very largely on developments in three strategic interrelated areas—(*a*) fiscal management and the evolution of appropriate government revenue and expenditure patterns, (*b*) the growth of the business (and particularly the corporate) sector and (*c*) the elaboration of mechanisms enabling individuals to contribute to the functioning of a capital market.

The budget plays a crucial role in the financing of economic development partly because of its sheer size relative to other operations in most developing countries and partly because it entails a compulsory and direct transfer of resources. The efficacy of this transfer, from the point of view of financing development, depends upon the extent to which it draws resources from consumption and makes them available for well-conceived investment. Post-war history has not been reassuring in this regard: there has been an urgent need to improve public administration and raise the quantity and quality of public services, and government consumption has increased twice as fast as private consumption and much faster than gross capital formation, particularly in recent years. A number of governments have been net dis-savers in the nineteen sixties so far and a majority have been saving relatively less than they were ten years earlier.

Though a good deal of experimentation has gone on in the past few years, both in widening the tax base and in planning investment priorities, no simple rule has emerged for maximizing the consumption-to-investment conversion achieved in this way. Indeed, recent fiscal history has served to emphasize some of the administrative and political difficulties hampering this type of transfer. Efforts to tax incomes that have a high import propensity associated with them (usually the upper brackets) or to tax the purchases of goods of mass consumption (and hence the lower-income brackets) have often met with considerable resistance. Yet these efforts, and parallel efforts to improve the tax collecting system and streamline the public administration, hold the key to any general increase in the ability of governments to finance development.

Nor has the use of various types of public enterprise been uniformly successful as a means of transferring resources from consumption to investment. Government marketing boards which buy produce at a relatively low fixed price and sell it at higher but less stable prices have yielded substantial profits for investment in some cases but have encountered various difficulties in others. Where the product is exported (as in the case of cocoa, for example), world prices have sometimes fallen below the domestic purchase price. Where the latter has been held down unduly, production incentives have suffered and the lag has sometimes been reflected in total output (as in the case of various farm products in a number of countries). In many instances, moreover—especially in inflationary situations—public utilities and state trading operations have been conducted in a manner designed to sustain levels of consumption rather than to free resources for investment: losses on public transport, power and communications undertakings and on food distribution, indeed, have often helped to cause or swell budgetary deficits.

The impact of a deficit in the government's current account depends in part on the way in which the capital account is financed. Some of the smaller countries have been able to rely on budget support from abroad, but most have to draw on local resources. Where a government finds it difficult to borrow—either because of the rudimentary status of the local capital market or because inflation has made conventional lending too unattractive—a failure to generate a surplus on current account increases its reliance on the central bank for its funds for investment. And, particularly where confidence in the stability of the currency has been impaired, drawing on the banking system in this way has often served to exacerbate inflationary pressures.

The government's role in financing economic development through its capital budget is inversely related to the evolution of the private business sector: deficiencies in the latter tend to increase the importance of the former. The relationship is manifested within the fiscal structure itself: a nice balance usually exists between the need to maximize the revenue derived from taxes on business earnings and the desirability of encouraging corporate forms of organization and the saving function they perform.

The importance of corporate bodies in most developing countries lies not only in the saving that they themselves tend to do from their own earnings but also in their capacity to economize in the almost universally scarce factor of entrepreneurship, often placing at its disposal the proceeds of small private savings that might otherwise not be productively used. The precise form of organization most appropriate for the purpose—partnership, co-operative, company or other joint enterprise—varies from country to country and even from one industry to another, but for maximum effectiveness in mobilizing savings one of the most important features seems to be the degree of confidence inspired by corporate law and practice, particularly that governing invitations to the public to subscribe or participate. Economic development often requires more than family-based entities; means must be found to pool individual resources in common enterprises.

The law governing such enterprises is thus a cornerstone of the capital market. In most developing countries, however, the links between the small saver and the actual or potential entrepreneur still tend to be extremely tenuous, and a good deal of experimentation has been taking place in recent years in devising institutions to stimulate and facilitate the flow of savings from generator to user. The most essential attributes are reliability and convenience, especially in rural communities on the fringe of the monetary system, where the provision of credit at critical times is often necessary to make possible saving at more favourable times. Indeed in low-income, agricultural populations, saving depends very largely on keeping windfall gains—from harvest or price changes, for example—from being dissipated in traditional forms of consumption. This requires the judicious use of localized institutions, such as co-operatives, which build up confidence and influence peasant attitudes towards the distribution of income over time.

The evidence of institutions established to mobilize savings indicates that in many developing countries there is a positive response among small savers to changes in interest rates. An additional incentive in the form of lottery prizes has been used successfully in some cases. By the same token, though moderate price increases have sometimes acted as a stimulant, rapid inflation has proved inimical to saving. In a few cases loan values have been secured by gold or purchasing power clauses; more widespread, however, has been the use of such devices as "mutual funds" through which savings are channelled directly into equity investments. Mutual funds have often been organized on a contractual basis calling for regular contributions from participants. More common as contractual savings have been pension and assurance funds: these have tended to grow fastest where prices were most stable.

Though some of the means used for promoting savings also serve to channel them to where they may be deployed to finance development, in most developing countries the capital market is still rudimentary in structure, and here, too, a good deal of institutional experimentation has been undertaken in recent years. Though the basic economic problem is esentially similar, a certain amount of specialization has occurred in most countries: institutions have been created to finance activities in specific sectors of the economy—agriculture, industry, housing and so on. By and large, the commercial banks have continued to concentrate on the provision of short-term credit, particularly for trade, drawing their funds chiefly from the cash balances of businesses. Small private savings have, in general, not moved to the newer financing institutions; they have stayed with the co-operative, insurance and building societies and savings banks—some operated by the government as an adjunct to the money-transmitting services provided by the department of posts and telecommunications.

Many of the newer institutions, particularly those with a definite development function, have been concerned more with lending than with generating or attracting savings; they still depend on appropriations from the central government budget for the bulk of their funds. Where their management and investment policies have been successful, however, some of these entities are in receipt of sizable and growing incomes from interest and dividends. Financial success has also brought an accretion of a factor that is less tangible but no less important, namely, public confidence. Thus, a few of the older institutions have broadened their role in the capital market by receiving deposits from individual and corporate savers and creating more specialized subsidiaries to direct investments in particular sectors of the economy.

While there is no universally valid prescription for success in this field, recent experience has pointed to the need, in each developing country, for at least one investment or lending organism from which small and medium-scale enterprises can seek finance. And there is an obverse need for an intermediary to handle, at what might be called the retail level, investment funds made available by the government treasury or derived from private domestic savers or even from external sources. In most developing countries the establishment of such an entity is an essential step in the evolution of a local capital market, and providing it is so regarded—and operated with efficiency and integrity—it may be expected to play a key role in implementing development plans, mobilizing private savings as well as channelling, in accordance with investment priorities, funds drawn from public sources.

PROBLEMS IN THE CAPITAL EXPORTING COUNTRIES

As a country develops, its capacity to supply its own investment needs tends to grow steadily greater. In the process of development, however, the availability of external resources is often of critical importance. At issue here is not only the volume of such resources but also their nature and the terms on which they are provided. This is an area in which the post-war period has seen some dramatic changes.

Perhaps the most marked contrast between recent and earlier international movements of capital lies in the role of private investment. In an earlier age, the lands of new European migration and settlement —North America, Oceania and parts of South America and southern Africa—were developed almost exclusively by the inflow of private capital, either for direct investment or as loans. In the interwar period the flow from Europe slackened and, apart from United States investment in Latin America, particularly in the nineteen twenties, the movement of resources to the lower-income countries was not reinforced to any marked extent by capital from the newly developed countries. In the post-war period, the United States emerged as the major source of capital, and there was some revival of private foreign investment in the lower-income countries, now beginning to make strenous efforts to modernize their economies. But the supply of private capital was small by earlier standards and was concentrated very largely in certain sectors and certain countries; it fell far short of the needs of the developing countries as a whole.

Militating against a rapid expansion in the flow of private investment has been the growth in demand for capital in the developed market economies themselves, brought about in the first instance by the pressing claims of reconstruction and soon reinforced by the full-employment policies pursued by all the governments concerned. Also magnifying the domestic needs for capital has been the extraordinary acceleration in the rate of technological change that has come to characterize the era. More recently, the achievement of convertibility of all the principal currencies, the vigorous growth in international trade and economic integration in western Europe all served to increase the demand for capital among the industrial countries.

The developing countries have not been able to offer any comparable attraction. Indeed, notwithstanding the widespread adoption of various fiscal incentives such as so-called "tax holidays", the emphasis in public discussions has remained very much on the negative aspects—on those policies pursued in the developing countries that are still regarded as deterrents by potential investors abroad, and those practices of foreign companies that are still regarded as inimical to the interests of the host country. In these circumstances, a large proportion of the direct foreign investment that has been made in the developing countries in the post-war period has been concerned with the exploitation of localized natural resources with a world-wide market, most notably petroleum, demand for which has advanced at a remarkably stable rate of about 7 per cent a year. Countries that lack a resource of this nature have attracted much less private capital, especially if their internal market is a small one.

Nor has there been any notable increase in private lending or portfolio investment. The international bond market has recovered only slowly from the defaults arising from the First World War and the Great Depression. Among the developing countries it is only those with special institutional ties to particular markets that have sought and obtained funds by issuing bonds in the post-war period. Most of the developing countries lack the credit standing necessary to give them access to the capital markets on economical terms.

With private direct investment fluctuating erratically from year to year and rather narrowly concentrated by country and sector, and private lending at a very low level by historical standards, the international flow of resources to the developing countries has originated increasingly in the public sector. This reflects in part the growing involvement of governments in the development process on the recipient side. But it also stems from the remarkable growth in concern and action on the part of governments in the countries able to export capital. Beginning with the reconstruction phase of the European Recovery Programme, this official concern became directed more and more towards the less developed parts of the world, involving the participation of an increasing number of the more advanced countries. It culminated in 1960 in the acceptance by the developed market economies of the principle of income sharing on a global scale, with a target for resource transfer denominated in terms of their national income.

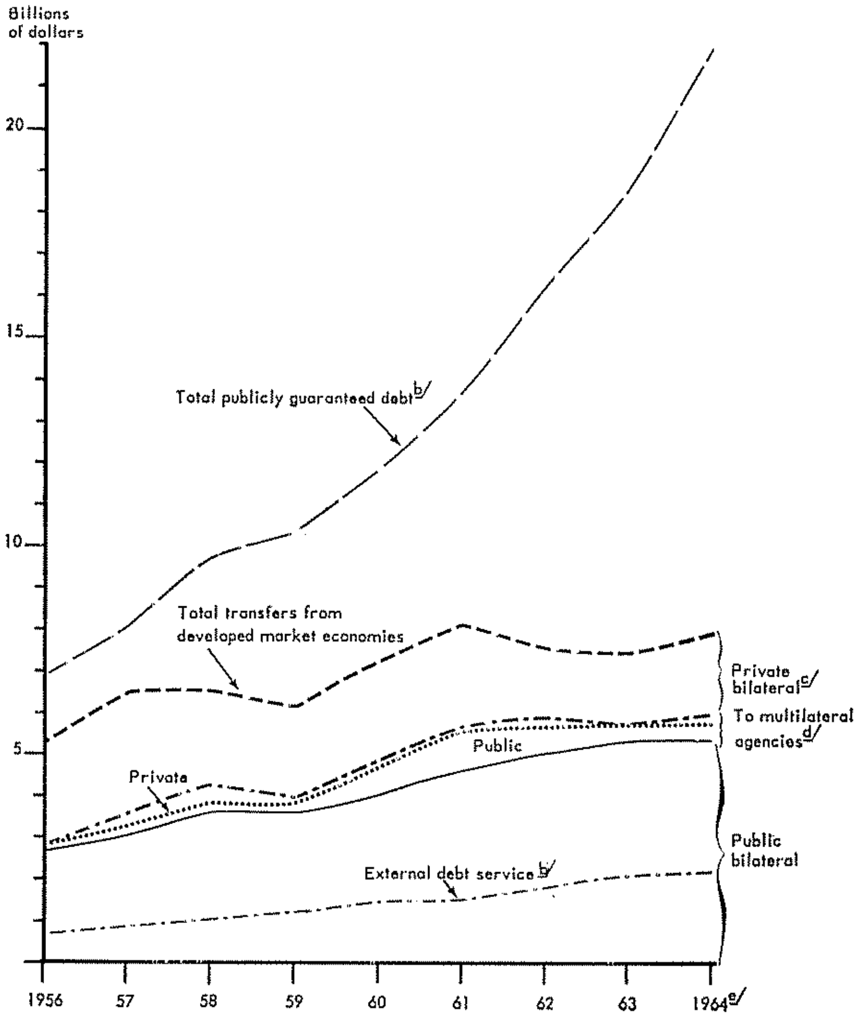
The need for public transfers to expand in volume was accentuated not only by the slowness and irregularity in the growth of private capital flows but also by a deterioration in the trading position of most of the developing countries. This stemmed in part from the change in supply/demand relationships on the world market consequent on the recovery of productive capacity from wartime disruption. It was accentuated by the relatively unfavourable evolution of external demand for many of the commodities exported by the developing countries and, in some cases, by changes in domestic production and consumption which tended to reduce exportable supplies. In the event, the second half of the nineteen fifties saw a marked slackening in the rate of increase in the export earnings of the developing countries, accompanied by a rapid upsurge in publicly sponsored resource transfers from the more advanced countries (*see* figure II).

One of the consequences of the relative decline in the role of direct foreign private investment as an instrument of development has been a proliferation of types of public transfer: the package of goods and services ordinarily provided by such investment has in effect been split into its major components, and in various ways arrangements for their transfer are separately made. Thus the public flow comprises cash loans for different purposes and on different terms, cash grants for more or less specific purposes, and a considerable range of grants in kind, including food-stuffs and other commodities, technical skills and other expertise to operate in the recipient country, and the education and training of nationals of the recipient country in the institutions of the donor country.

In some ways the developing country may find this loose assortment of available resources easier to integrate into the framework of a development plan than the package embodied in a direct investment over which only a broad general control can be exercised. Its relative efficiency for financing development depends upon conditions and circumstances, and in some cases—notably where patents, industrial know-how and particular operational techniques are involved—it may not provide a suitable substitute for the relevant form of direct investment. Moreover, in so far as loan debt replaces equity liability, a more rigid element is built into the balance of payments. Indeed, one of the most awkward results of the rapid rise in public lending in the past ten years has been the concomitant growth of the debt service burden: in some countries this has begun to pre-empt so large a proportion of foreign exchange receipts that credit-worthiness

Figure II. Flow of resources from the developed market economies to the developing countries and the multilateral agencies, and growth of public-guaranteed external debt and service payments of developing countries,[a] 1956-1964

(*Billions of dollars*)



Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on Organisation for Economic Co-operation and Development, *The Flow of Financial Resources to Less Developed Countries, 1956-1963* (Paris, 1964); *Development Assistance Efforts and Policies, 1965 Review, Report of the Chairman of the Development Assistance Committee* (Paris, 1965); International Monetary Fund, *Balance of Payments Yearbook* (Washington, D.C.); Special Questionnaire issued jointly by the United Nations Secretariat and the International Monetary Fund; *Proceedings of the United Nations Conference on Trade and Development, Volume V, Financing, Invisibles and Institutional Arrangements* (Sales No.: 64.II. B.15), and International Bank for Reconstruction and Development.

[a] *Developed market economies* comprise Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, Finland, France, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, South Africa, Sweden, Switzerland, United Kingdom and the United States. This list differs from that of Group B specified by United Nations Conference on Trade and Development (UNCTAD) in recommendation A.V.1 by the inclusion of South Africa and the omission of Cyprus, Greece, Holy See, Liechtenstein, Monaco, San Marino, Spain and Turkey. *Developing countries* comprise all countries and territories in South and Central America (other than Puerto Rico), Africa (other than South Africa), Asia (other than mainland China, Cyprus, Japan, Mongolia, North Korea, North Viet-Nam and Turkey) and Oceania (other than Australia and New Zealand). This list differs from that of Group A specified by UNCTAD in recommendation A.V.1 by the omission of Mongolia, South Africa and Yugoslavia.

All figures are net of repayment or repatriation of principal, disinvestment and retirement; they are not net of reverse flows of capital originating with residents of developing countries, or of investment income. Government-guaranteed export credits are not included except in so far as they are used and reported under private portfolio investment or other private lending. The data are thus in accord

—as measured by the capacity to carry additional debt—has been thrown in doubt.

This rise in debt has also posed a major problem for the lending countries. Apart from the occasional emergency action they have been forced to take in order to consolidate, refinance or reschedule the debt of particular developing countries faced with a liquidity crisis, the need to ease the terms applicable to new loans has become steadily more apparent. Unless the burden of service payments is held down, the gross flow of resources will have to increase very rapidly if the net transfer is to expand. As in the case of the refinancing arrangements and other exercises that involve burden sharing, the easing of terms can be effected more readily by joint action of the lending countries. And it was in pursuance of this principle that in 1965 a subsidiary set of targets was proposed to OECD members designed to reduce the average rate of interest and lengthen the average tenor of future public lending to developing countries.

The pressure to increase the sub-market component of loans to the developing countries has tended to accentuate the various problems associated with the growth in public involvement in this transfer of resources. Many of the developed market economies have found it necessary to set up a special government department to deal with the wide range of activities that the diversity of both the resources in question and the recipient countries has come to entail. And most of the developed market economies face a variety of difficulties in financing their so-called "foreign aid" programmes. Though some of the money is drawn from the capital market, administration and the growing sub-market portion of the programme constitute direct claims on the budget. Winning parliamentary approval for such appropriations has often exerted a perceptible influence on the nature and extent of the operation: some types of transfer have proved to be more popular than others, and many governments have found it expedient to stress the tangible advantages that may accrue to the donor country from certain forms of assistance.

Perhaps the most important device of this nature is the so-called "tying" of the transfer in order to limit the usability of a cash loan or donation to the goods and services of the country granting it. Such tying, like transfers in kind and transfers defined by project, tends to reduce the flexibility of utilization and hence to detract from the value of the assistance. The disadvantage to the recipient varies with the degree to which choice is constrained, the import priority attaching to the resources actually obtained, and the competitiveness of their prices on the world market. Tying has increased significantly in recent years, partly as a result of contagion and partly under the impact of balance of payments pressures which have induced a number of the developed market economies to restrain the outflow of capital and to adopt other measures to protect their international liquidity.

Though the liquidity difficulties that have troubled individual countries in recent years reflect imbalances among the developed market economies themselves, they have tended to slow down the flow of resources to the developing countries. This has re-emphasized the international aspects of the problem—on the one hand the need of the capital exporting countries to act in concert in untying their aid and in harmonizing the terms on which it is provided, and on the other hand the possibility of adapting the world monetary system so that liquidity creation can be better controlled in the interest of international trade in general and the transfer of resources to the developing countries in particular.

Dependence on budgetary appropriations, which increases with the need to ease the terms on which resources are transferred, has been reduced in some countries by lowering the proportion of tax revenue used as capital and raising the proportion devoted to subsidizing the rate of interest on moneys drawn from the capital market proper. This may require special institutions, with a public guarantee of their debt, capable of borrowing at the going rate, but lending on terms considered more appropriate for developing countries. Up to now such arrangements have been made mainly in the field of trade credit, designed to ensure that export business is not lost

(Figure II Foot-notes continued from preceding page) with the definition of long-term capital and official donations adopted by UNCTAD in its recommendation A.IV.2.

[b] Total for the following thirty-five countries, estimated to account for about 80 per cent of the combined public-guaranteed debt of the developing countries: Argentina, Bolivia, Brazil, Burma, Ceylon, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Ethiopia, Guatemala, Honduras, India, Iran, Israel, Kenya, Malawi, Malaysia, Mexico, Nicaragua, Nigeria, Pakistan, Panama, Paraguay, Peru, Philippines, Rhodesia, Sudan, Tanzania, Thailand, Uganda, Uruguay, Venezuela and Zambia. Debt service refers to interest and amortization payments in respect of the public-guaranteed debt.

[c] Including re-invested earnings, in some cases on the basis of estimates.

[d] Including grants and other contributions, capital subscriptions, repayments of loans made earlier by the agencies to the developed market economies, participations and purchases of bonds (all measured net of repayments to and disbursements in the developed market economies) relating to EDF, IBRD, IDA, IDB, IFC, UNEPTA, UNFC, UNHCR, UNICEF, UNRWA, UNSF, UNTA, and WFP. Contribution to the regular budgets of the United Nations and specialized agencies are not included.

[e] Preliminary, based in some cases on estimates, especially for private capital movements.

for lack of suitable finance, but their use for other forms of transfer—including those made multilaterally—has been under discussion in various forums.

The problem of dealing with the transfer of resources to the developing countries in the light of competing domestic claims has posed difficulties for the centrally planned economies no less than for the developed market economies. Most of the transfers from the centrally planned economies have been in a form akin—in economic terms though not in ownership—to direct investment: they represent enterprises or projects made available as more or less complete entities financed by credits of up to fifteen years at up to 3.5 per cent *per annum* interest. Such transfers have given rise to problems of integration with investment plans not only at the recipient end but also in the exporting country. In many cases allowance has had to be made not only for the provision of the original equipment and skills but also for the subsequent use of goods—usually primary commodities, but also the semi-finished output of the new project itself—in which repayment of the original credit has often been authorized.

Having been concentrated in a relatively small number of developing countries, these transfers and the subsequent servicing of the debt have exerted a significant effect on the volume and composition of trade between the centrally planned economies and the countries in question. This has added to the desire of the capital exporting country to organize the process in closer conformity with domestic planning criteria. And this in turn has given rise to a good deal of discussion of the problem of appropriately pricing both the outflow of capital goods and associated services and the return flow of goods in respect of interest and amortization. It has also led to a search for ways and means of multilateralizing the flows, so as to permit, for example, some of the needs of eastern European countries for raw materials to be met from trade flows from developing countries now directed to the Soviet Union.

Trade prices also affect the real scale of transfers from the developed market economies. This is not only a question of the prices at which various forms of "tied" transfers and transfers-in-kind are in fact valued. During the second half of the nineteen fifties the deterioration in the terms of trade of the developing countries as a group offset much of the effect of the rising volume of loans and grants. By the same token, resources may be transferred to a developing country through special trade arrangements which result in its receiving a higher-than-market price for its imports. Subventions of this nature are generally paid directly by consumers of the products in question in the importing country, and not by the taxpayer through the fiscal system. Their contribution to development finance in the developing country depends, *inter alia*, on whether it flows in as income to those engaged in exporting or is caught by a tax and used in public investment

International involvement in development financing

Parallel with the expansion of bilateral transfers from the public sector has been the growth of international concern and action. Basically this reflects the involvement of the international community with development problems as such, in line with the economic objectives of the United Nations Charter itself. But the nature of the action and the form of the instruments through which it has found expression have been shaped by a variety of considerations as well as by the course of events in the post-war period. Some multilateral transfer mechanisms have been a by-product of trading arrangements and some, conversely, a means of compensating for the abandonment of earlier trading arrangements. The maintenance of international liquidity has been the origin and purpose of other transfer mechanisms. Some arrangements have been motivated by creditor countries seeking jointly to protect their claims and ensure their future trade with particular debtors. The search for ways and means of sharing most equitably the acknowledged obligation to provide resources to the developing countries has been a common influence towards multilateral action. Some of the smaller capital exporting countries have actively sought the convenience of international institutions for effecting the transfer of their contributions. Pressure from the developing countries themselves to have an "independent" entity from which to obtain resources also lies behind the establishment of international transfer mechanisms. And from time to time, emergency situations have stimulated international action for the purpose of relief or rehabilitation.

The institutions concerned with the transfer of resources to the developing countries also reflect the changes in purpose, form and content that have characterized capital movements in the post-war period. Starting with what might be regarded as the more conventional lending institutions established at the Bretton Woods Conference in 1944—the IBRD for long-term lending to governments and the IMF for short-term accommodation—the range of organs has extended progressively over the whole spectrum of transfers.

The IFC was set up to handle equity participations, the IDA to dispense "soft" loans, regional development banks, for Latin America, Africa and, more recently, south-eastern Asia, to deal with various types of finance for joint and individual projects within their respective regions, and the EDF to handle transfers—mostly grants—to developing countries associated with the EEC.

Within the United Nations proper, arrangements for providing technical assistance were among the earliest results of the debate of the Economic and Social Council (ECOSOC) on development problems; later the effort was expanded into an operation involving all the specialized agencies and financed by voluntary contributions of member countries. The range of activities was further extended by the establishment of a Special Fund whose functions were conceived of as preparatory to the major forms of investment—surveys of natural resources and training of human resources, for example. Most recently the various elements were brought into a closer relationship in the framework of a United Nations Development Programme.

A number of other United Nations programmes serve to transfer resources to the developing countries for various continuing purposes, such as assistance to children or refugees, or for special *ad hoc* purposes, such as relief in particular areas of United Nations responsibility (Palestine, Korea, Congo, and so on). Each of these programmes has some definite, but not always easily measurable, development content. Concerned more directly with the transfer of physical resources is the newest among the institutions—the World Food Programme. Run jointly by the United Nations and the Food and Agriculture Organization, the World Food Programme is responsible for various types of food aid.

These multilateral channels of assistance derive their resources very largely from the contributions and subscriptions of participating governments, and, hence, by way of budgetary allocation. Only a small proportion of the total—about one-sixth in the period 1961-1964—has been drawn from private contributions of a charitable nature or from the participation of private investors in the lending operations of the banks. To the government of the capital exporting country, therefore, the decision about furnishing funds to international development institutions is in many cases less a matter of the needs or wishes of the recipient countries than of the nature and purpose of its own foreign aid policy and the convenience of having funds handled multilaterally. Smaller countries tend to channel a larger proportion of such funds through the agencies: most of them have refrained from setting up the sort of machinery that some of the larger countries have found necessary to administer their foreign aid policies. In some of the latter, special historical ties with particular developing countries make for a good deal of bilateral activity. In the aggregate, the multilateral proportion has shown little tendency to increase in the past ten years: among the developed market economies, the resources channelled through the institutions have accounted for about 14 per cent of total official grants and loans, and less than 9 per cent of the aggregate outflow of long-term capital and donations, public and private.

The role of the international institutions is not accurately reflected in the relatively small proportion of the transfers that they actually handle. The activities of the institutions, the debates in their councils and the confrontations that occur in pledging sessions have all contributed not only to raising the total volume of resources made available for transfer to the developing country but also to making the conditions and forms of transfer more appropriate to the needs of the recipients. For this purpose, indeed, it has been found convenient to create international organisms to deal with specific transfer problems. The most formal of these—the so-called "consortia" connected with the external financial needs of individual countries—have engaged not only in the analysis of requests for and use of external resources by the particular developing countries but also in a form of pledging exercise designed to spread the burden of the intended transfer equitably among the participating capital exporting countries. Less formal, and focused more on the requirements and performance of the developing countries concerned, are the so-called "consultative groups" sponsored chiefly by the IBRD: they are designed to guide and advise individual countries regarding the formulation of a development plan and its financing. Though no pledging is involved, the participation of various capital supplying countries is intended to interest them in the problem of financing, while at the same time assisting the developing country to select the most appropriate method of financing the various projects that constitute its investment programme for the period ahead.

Aside from these operational bodies, the discussions in various deliberative forums—most notably the ECOSOC and the General Assembly and more recently the UNCTAD—have continued to stress the international implications of under-development and of efforts to raise levels of living in the lower-income countries. There has been a widespread acceptance of the obligations to reduce the disparity by sponsoring self-help and to engage at the international level in income sharing practices that have long been accepted at the national level Broad but fairly detailed guide-lines for financial co-operation were recommended without dissent by the 120 countries that deliberated on the problems of development financing on an unprecedented scale at the first UNCTAD in 1964, and specific targets for economic "growth and aid" were endorsed by 107 of these countries While it is now universally recognized that the problems of economic development are not only, or even mainly, financial problems, there is a corresponding acknowledgement of the fact that finance may constitute a major bottle-neck and that there is a vital external component of this, responsibility for which is shared by the international community.

With the subject under regular discussion there can be little doubt that the principles of public finance on a global scale will continue to evolve. Full recognition of the real nature of the problems would enable the international community to resolve the paradox implicit in the fact that, notwithstanding the adoption of growth and capital flow targets, the first half of the Development Decade has seen the more advanced countries transfer a steadily declining proportion of their national income to the developing countries. Escape from the present impasse would appear to require changes in at least two areas. In the first place, transfers to the developing countries should be made less dependent on the state of balance among the more advanced countries. And in the second place, thinking and policies need to break loose from the limitations connoted in the very term "foreign aid", which conjures the image of charity to a stranger rather than the provision of needed resources to an ailing or lagging part of the body economic. The emphasis may have to shift from general policies and total resource flows to the more pragmatic questions of actual need and performance —how these are to be measured and interpreted, and how particular lags and gaps can be discerned early enough to facilitate remedial action, both domestic and international. Only in this way can the international community hope to translate the principles of financing co-operation into growth promoting and growth sustaining practice.

Chapter I

FINANCING INVESTMENT IN THE DEVELOPING COUNTRIES

Ranking high among the conditions that must be met before a developing country can cross the threshold into self-sustaining growth is the availability of an adequate volume of saving to make possible the required level of capital formation. But many things other than capital are necessary to achieve economic growth. Indeed, unless it is backed by an appropriate array and quantity of complementary factors (human skills and knowledge and raw materials, energy and other resources) and unless it operates in an appropriate environment (with reasonably stable social and political conditions and an adequately motivated population), capital is unlikely to be very productive.

Apart from the variability in the supply and quality of all the required complementary factors, the pattern of investment in a developing country may differ considerably from one period to another. At times, saving may be promptly translated into productive investment; at other times, supply bottlenecks may slow down the process of capital formation; and while some types of investment may serve to raise production in a specific sector very rapidly, other types may yield only a slowly maturing improvement to the economy as a whole. There is thus no simple or stable general relationship between the deployment of capital and the total output of the economy.

Notwithstanding this possibility of widely differing results, however, it is clear that investment does increase productivity and that the rate of growth in the output of a given economy depends in part on the rate of capital formation. And among countries that are at a similar stage of economic development, there is a fairly systematic relationship between investment and production averaged over a number of years. During the ten years ending in 1963, for example, about 70 per cent of the developing countries had an incremental capital-output ratio of between three and four; that is to say, to obtain an additional dollar of annual production necessitated, on the average, the investment of between \$3 and \$4 (*see* table I-1).

Thus, although a given rate of investment does not assure a particular rate of growth in production, to

Table I-1. Developing countries: Rate of growth of real output and relationship between investment and output, 1953-1954 to 1962-1963[a]

Country[b]	*Rate of growth in gross domestic product*[c] *(percentage per annum)*	*Gross domestic capital formation as percentage of gross domestic product*[d]	*Incremental capital-output ratio*[e]
Israel	11	29	3
Trinidad and Tobago	10	27	3
China (Taiwan)	7	20	3
United Arab Republic	7	17	2
Mexico	6	15	2
Venezuela	6	24	4
Thailand	6	18	3
Iraq	6	17	3
Brazil	6	16	3
Panama	5	14	3
Syria	5	15	3
Peru	5	23	4
Iran	5	14	3
Ghana	5	19	4
Costa Rica	5	18	3
Philippines	5	9	2
Burma	5	19	4
Dominican Republic	5	14	3
Sudan	5	11	2
Republic of Korea	5	14	3
Rhodesia and Nyasaland	5	25	5
Guatemala	4	12	3
Federation of Malaya	4	14	3
Ceylon	4	15	3
Colombia	4	21	5
Ecuador	4	17	4
India	4	15	4
Kenya	3	18	5
Chile	3	11	3
Pakistan	3	11	3
Paraguay	3	15	5
Uganda	3	12	4
Nigeria	3	11	4
British Guiana	3	22	8
Argentina	3	20	8
Morocco	1	13	9
Uruguay	—	17	f

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on data from United Nations, *Yearbook of National Accounts Statistics*, and from national sources.

[a] For the following countries, the period differs from that stated: Costa Rica, Morocco, Nigeria, Panama, the

achieve an acceleration in growth necessitates an increase in investment. And to raise the investment rate a higher proportion of income has to be saved. While this is essentially a task for the domestic economy, involving decisions regarding the level and movement of consumption—public and private—resources can be augmented by drawing on the savings made in other countries. Such foreign savings play a strategic role in most developing countries and a predominant role in some.

(Foot-notes to table I-1 continued from preceding page)

Sudan, and Trinidad and Tobago, 1953-1962; British Guiana, 1953-1960; Ceylon, 1956-1963; Uruguay, 1955-1963; the Federation of Malaya, 1955-1962; and Iran, 1955-1961. For the following countries, data are for fiscal years: Burma (ending September), India (beginning April), Iran (beginning 21 March), Pakistan, Sudan and the United Arab Republic (beginning July). For Syria, gross national product is used. Capital formation data for Kenya, Mexico, Nigeria, Syria and Uganda exclude changes in stocks. All data are in constant prices.

[b] Countries are arranged in descending order of rates of growth of gross domestic product.

[c] The rates of growth in gross domestic product refer to annual compound rates between biennial averages at the beginning and end of period.

[d] Calculated by dividing the sum of gross domestic capital formation by the sum of gross domestic product over the entire period.

[e] Average incremental capital-output ratios have been calculated by dividing the ratio of gross domestic capital formation to gross domestic product by the annual rate of growth in gross domestic product.

[f] Rate of growth was slightly negative.

In the aggregate, nevertheless, it is on domestic saving that the developing countries must rely to maintain and accelerate their economic growth, and the problem ahead is how to increase it at a satisfactory rate in the light of population expansion and production and consumption objectives. The problem is primarily one of generating the necessary savings but it is also one of appropriate deployment. Though investment policies lie beyond the scope of the present *Survey*, the problem of making savings available for investment has to be recognized as an integral part of the process of mobilization. The instruments devised for canalizing savings into the financing of development are often the means of stimulating the saving function itself. The generation of savings, the mobilization and canalizing of savings and the financing of investment are thus closely interconnected processes on which the course of economic development largely depends.

The supply of savings

The volume of savings available for financing investment in the developing countries is characterized by marked country-to-country differences, by a high, though also widely varying, dependence on foreign sources and by its inadequacy in relation to most production growth objectives.

In relation to total output in recent years, the supply of saving has ranged from less than one-eighth to almost one-third (*see* table I-2). It has also changed at markedly different rates: over the ten years ending in 1964, for example, the relative supply of savings declined in a number of countries and rose by as much as 6 per cent of the gross domestic product in others (*see* table I-3).

The foreign component of these savings also differs considerably from one country to another. In some, particularly countries with a large established foreign-owned sector—Iraq, the Federation of Malaya, Mauritius and Venezuela, for example—foreign saving may be negative in individual years when surpluses earned in the country are repatriated or invested abroad. In others, foreign saving constitutes as much as one-fifth of gross domestic product and contributes more to local investment than does domestic saving. There is, indeed, a distinct tendency for foreign saving to be inversely related to domestic saving, deficiencies in the latter being made up to some extent by a larger volume of the former (*see* figure III).

Foreign saving has also changed over time to widely differing degrees. Over the ten years ending in 1964, for example, the contribution of foreign saving declined sharply in some of the countries in which foreign direct investment has been important (Jamaica, and Rhodesia and Nyasaland, for example) and in some of the countries that have received external resources in other forms (China (Taiwan), Israel and the Philippines, for example). But it increased equally sharply under similar influences in other countries—in the Federation of Malaya and in Trinidad and Tobago as a result of direct investment, for example, and in Ceylon and in India as a result of public loans and donations. And on balance the significance of foreign saving was greater at the end of the period than at the beginning: in only one-third of the countries for which data are available had domestic saving increased to a greater extent than foreign saving.

Though the nineteen sixties have seen a decline in its relative magnitude, foreign saving continues to play a strategic part in the process of economic development.[1] Domestic saving rates have been inch-

[1] This aspect is taken up in the last section of the present chapter.

Table I-2. Developing countries: Levels of foreign and domestic saving, average 1962-1964[a]

(Percentage of gross domestic product)

Country[b]	Total supply of saving[c]	Total net saving[d]	Foreign saving[e]	Total gross domestic saving[f]	Depreciation[g]	Net domestic saving[h]
Israel	31	22	23	8	9	—1
Trinidad and Tobago	28	18	9	19	10	9
Tunisia	22	20	12	10	2	8
Thailand	20	15	2	18	5	13
China (Taiwan)	20	13	2	18	6	11
Colombia	19	10	4	16	9	6
Jamaica	19	11	3	15	7	8
Rhodesia and Nyasaland	19	12	—	18	6	12
United Arab Republic	18	16	4[i]	14	2	12
Venezuela	18	9	—4	23	9	13
Burma	18	12	—	18	6	12
Federation of Malaya	18	13	—2	20	5	15
Ghana	17		4	13		
Mauritius	17	..	—5	22	..	..
Panama	17	11	9	8	5	3
India	..	13	3	..	..	10
Ecuador	17	12	3	14	5	9
Republic of Korea	16	11	10	6	5	1
Bolivia	16	10	7	9	6	3
Paraguay	16	10	2	14	6	8
Sudan	16	14	3	12	2	10
Costa Rica	15	10	5	10	5	5
Uruguay	15	11	2	13	4	10
Mexico	15		2	13		
Jordan	14		21	—6	...	
Philippines	14	8	—1	15	6	9
Ceylon	14	9	2	12	5	7
Honduras	14	9	2	12	5	7
Iran	14	9	1	13	5	8
Iraq	14	8	—1	15	5	9
Chile	13	5	3	11	8	3
Morocco	12	8	1	10	3	7
Tanganyika	11	6	—1	12	5	7
El Salvador	11	7	—	10	3	7
Guatemala	11	7	3	8	5	4
Republic of Viet-Nam	10	5	14	—4	5	—9
Median	16	11	3	13	5	8

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on data from United Nations, *Yearbook of National Accounts Statistics*, and from national sources.

[a] For the following countries, the period differs from that stated: Burma, 1960/61-1962/63 (fiscal years ending in September); India, 1960/61-1962/63 (fiscal years beginning in April); Iran, fiscal year beginning 21 March; Sudan, 1960/61-1962/63 (fiscal year beginning in July); Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Israel, Iraq, Jordan, Federation of Malaya, Paraguay, Rhodesia and Nyasaland, and Uruguay, 1961-1963; Panama, Trinidad and Tobago, 1960-1962; United Arab Republic, 1960-1961. For India, the data are based on net domestic product at factor cost.

[b] Countries are arranged in descending order of percentage of total supply of saving to gross domestic product.

[c] Total supply of saving is the sum of depreciation, net domestic saving and foreign saving.

[d] Total net saving equals foreign saving plus net domestic saving.

[e] Foreign saving is equal to payments for imports of goods and services (including factor income paid abroad) minus receipts from exports of goods and services (including factor income received from abroad). A positive foreign saving figure represents an excess of receipts over payments.

[f] Total gross domestic saving equals net domestic saving plus depreciation (or total supply of saving minus foreign saving).

[g] Depreciation is the provision for the current value of wear and tear, obsolescence and accidental damage to fixed capital.

[h] Net domestic saving is the sum of the surplus of incomings over outgoings in the current accounts of government, enterprises, households and private non-profit institutions. Transfers to and from the rest of the world are excluded from the income and expenditure accounts in estimating the saving of these sectors.

[i] Deficit of the nation on current account.

Table I-3. Developing countries: Relative change in foreign and domestic saving, 1953-1955 to 1962-1964[a]

(Percentage of gross domestic product)

Country[b]	Total supply of saving	Total net saving	Foreign saving	Gross domestic saving	Net domestic saving
Federation of Malaya	7	6	7	—1	—1
Trinidad and Tobago	6	5	5	1	—
Sudan	6	6	3	3	2
Panama	6	7	4	1	2
Philippines	6	5	—3	9	8
Chile	5	6	2	2	3
India	.	5	3	.	2
Jamaica	4	3	—5	8	7
Thailand	4	4	—1	4	5
Ceylon	4	—2	6	—2	—6
China (Taiwan)	3	2	—4	7	6
Republic of Korea	3	3	3	1	—
Mauritius	3		1	2	.
Colombia	3	—	2	—	—3
Guatemala	2	2	3	—1	—1
Ghana	2	.	2	—	
Paraguay	1	1	—	1	—
Ecuador	1	1	1	—	—
Mexico	1		1	—	.
Israel	1	—	—3	3	2
Uruguay	—	—	—1	1	2
Honduras	—1	—1	1	—1	—1
Iraq	—2	—2	4	—6	—5
Costa Rica	—2	—2	2	—4	—4
Burma	—3	—3	2	—4	—5
Rhodesia and Nyasaland	—11	—11	—7	—3	—4

Source: See table I-2

[a] For definitions, *see* table I-2. For the following countries the earlier period is as follows: India, 1953/54-1955/56 (fiscal year beginning 1 April); Rhodesia and Nyasaland, 1954-1956; Colombia, Federation of Malaya and Uruguay, 1955-1957; the Sudan, 1955/56-1957/58 (fiscal year beginning 1 July)

[b] Countries are arranged in descending order of the change in total supply of saving

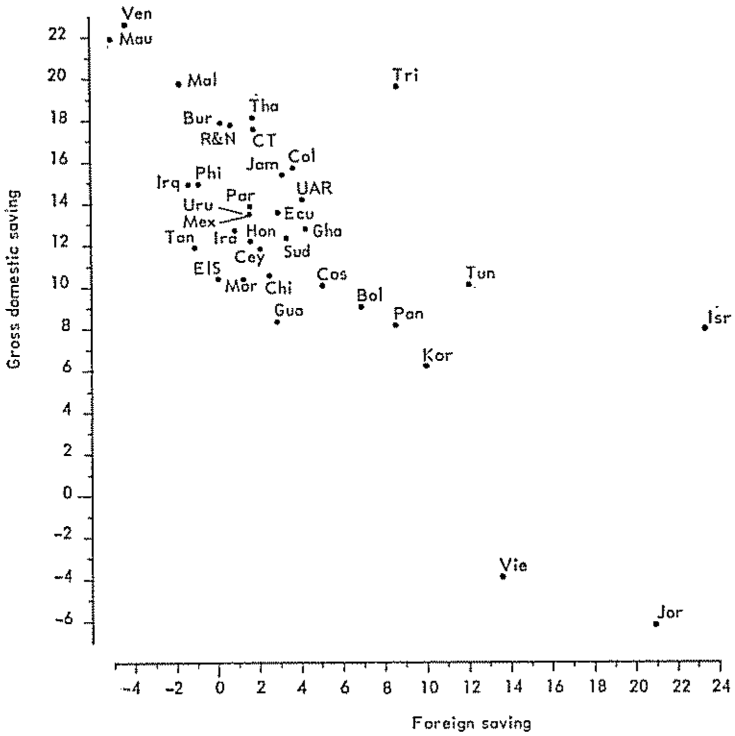
ing up very slowly: it has taken about ten years for the average to rise by one per cent of the gross domestic product. The considerable gains made in some countries (China (Taiwan), Jamaica, the Philippines and Thailand, for example) between 1954 and 1964 were largely offset by reductions in others (Burma, Costa Rica, Iraq, and Rhodesia and Nyasaland, for example). And altogether only about half of the developing countries for which data are available registered a measurable increase in domestic saving rates.

On the average in 1962-1964, there were as many developing countries saving less than 13 per cent of their gross domestic product as there were countries with higher saving rates. In contrast, very few of the more advanced countries save less than 20 per cent of their gross domestic product. Moreover, on the basis of the incremental capital-output ratio common to a large majority of the developing countries, a 13 per cent rate is unlikely to sustain a growth rate of more than 4 per cent a year. Such a rate would be inadequate not only in relation to the 5 per cent target that has been set for the Development Decade, but also in relation to current and prospective rates of population increase, which would require a 3 per cent growth rate merely to prevent a decline in *per capita* income.

Even assuming that there were no serious problems in earning the necessary foreign exchange, it is unlikely that more than a small handful of developing countries could attain or sustain a 5 per cent rate of increase in production on the basis of their savings performance during the past ten years. Though, on the average, less than one-fourth of the total supply of savings comes from abroad, yet for many countries this increment means the difference between economic stagnation and a rising level of living. The lesson of the arithmetic of this period is that only a major effort to raise domestic saving rates will assure reasonable economic growth in the future.

Figure III. Developing countries: Relation between gross domestic saving and foreign saving, average 1962-1964[a]

(Percentage of gross domestic product)



Bol	Bolivia	Mal	Malaysia
Bur	Burma	Mau	Mauritius
Cey	Ceylon	Mex	Mexico
Chi	Chile	Mor	Morocco
CT	China (Taiwan)	Pan	Panama
Col	Colombia	Par	Paraguay
Cos	Costa Rica	Phi	Philippines
Ecu	Ecuador	R&N	Rhodesia and Nyasaland
El S	El Salvador	Sud	Sudan
Gha	Ghana	Tan	Tanganyika
Gua	Guatemala	Tha	Thailand
Hon	Honduras	Tri	Trinidad and Tobago
Ira	Iran	Tun	Tunisia
Irq	Iraq	UAR	United Arab Republic
Isr	Israel	Uru	Uruguay
Jam	Jamaica	Ven	Venezuela
Jor	Jordan	Vie	Viet-Nam (Republic of)
Kor	Korea (Republic of)		

Source and foot-notes: *See* table I-2.

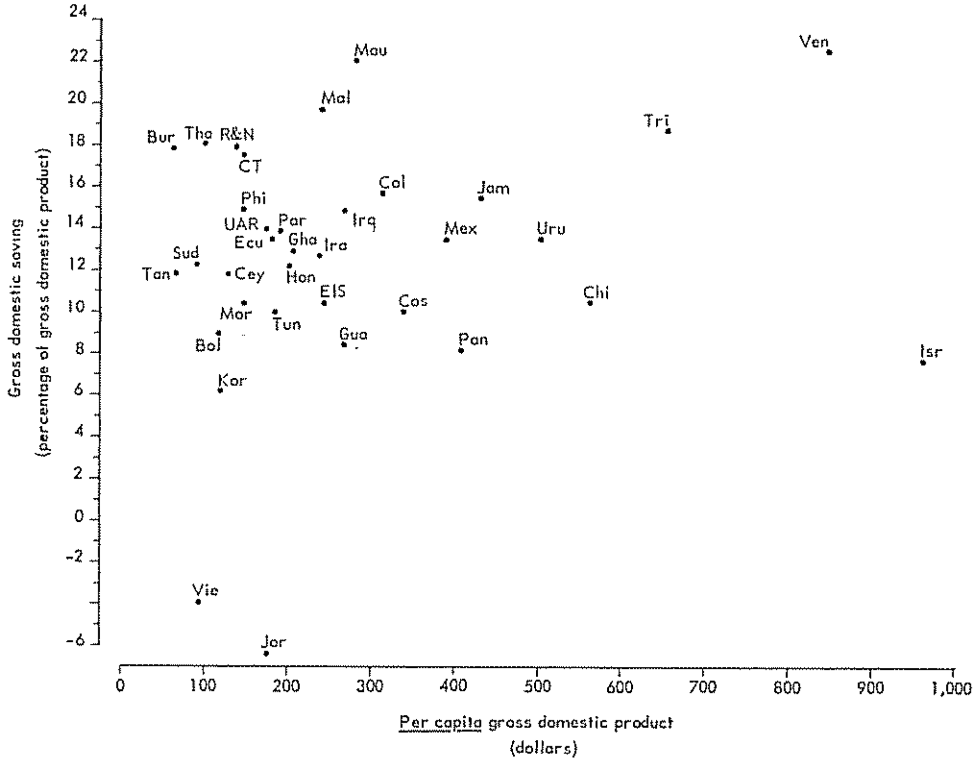
The mobilization of domestic savings

Inasmuch as saving is the alternative to consumption in the disposition of income, experience suggests that saving rates should rise as average income rises. At low levels of income, consumption tends to preempt all or most of it, but as income rises the proportion that can be diverted to savings also tends to increase. Moreover, while at low levels any increase in income is likely to go entirely, or almost entirely, into consumption, at higher income levels increments move more readily into saving.

This relationship between savings and income lies at the root of the difficulty that most developing countries have in raising their saving rates. Given the pattern of incomes that tends to characterize countries with a relatively large traditional, more or less subsistence sector, an increase in average *per capita* income does not automatically assure a higher rate of saving. Indeed, because of the great differences in the ways and amounts in which incomes actually accrue to individuals, there is little tendency for rates of domestic saving to be systematically related to *per capita* output or income (*see* figure IV). Not only may personal income distribution vary widely—depending upon occupational structure and stage of economic development—but the flow to business entities and to the various levels of government may differ markedly from one country to another.

As the saving propensities of these various recipients of income are usually quite different, the problem of increasing savings transcends that of raising income levels. Indeed, in terms of develop-

Figure IV. Developing countries: Relation between *per capita* gross domestic product in 1963 and gross domestic saving rates in 1962-1964



Bol	Bolivia	Mal	Malaysia
Bur	Burma	Mau	Mauritius
Cey	Ceylon	Mex	Mexico
Chi	Chile	Mor	Morocco
CT	China (Taiwan)	Pan	Panama
Col	Colombia	Par	Paraguay
Cos	Costa Rica	Phi	Philippines
Ecu	Ecuador	R&N	Rhodesia and Nyasaland
EIS	El Salvador	Sud	Sudan
Gha	Ghana	Tan	Tanganyika
Gua	Guatemala	Tha	Thailand
Hon	Honduras	Tri	Trinidad and Tobago
Ira	Iran	Tun	Tunisia
Irq	Iraq	UAR	United Arab Republic
Isr	Israel	Uru	Uruguay
Jam	Jamaica	Ven	Venezuela
Jor	Jordan	Vie	Viet-Nam (Republic of)
Kor	Korea (Republic of)		

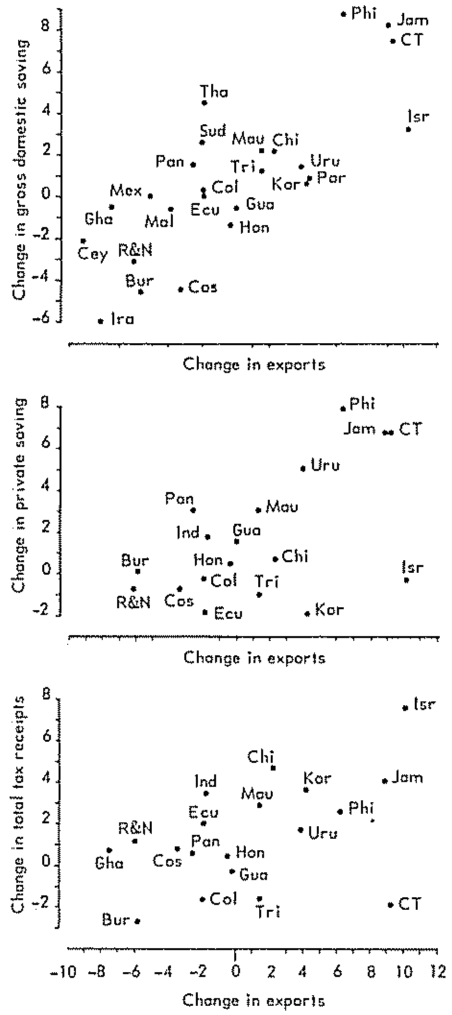
Source and foot-notes: *See* table I-2.

ment strategy, the increase in incomes is more logically regarded as a result to be achieved through policies aimed at raising saving rates. And as savings at one level (government, for example), may be at the expense of incomes—and hence savings—at another level (corporations, for example), these policies need to be framed in the light of the pattern and distribution of income in the country concerned.

Playing a vital role in the process of raising incomes as well as saving and investment in most developing countries is foreign trade. As a dynamic element in the economy—in contrast to the traditional and subsistence sectors—exports often tend to be closely related to domestic saving, by virtue of their influence on both government revenue and private income and savings (*see* figure V). Whatever the relative size of the export sector, moreover, foreign trade plays another and even more crucial role in the development process. For in most developing countries domestic savings cannot be translated into the sort of investment on which growth depends unless the economy has access to plant and equipment from abroad. Export earnings, supplemented by loans and grants of external resources, thus provide simultaneously additional income from which domestic savings can be generated and the foreign exchange with which critical elements in the real capital content of investment can be purchased.

Figure V. Developing countries: Relation between changes in saving and changes in tax receipts and in exports, 1953-1955 to 1962-1964[a]

(*Percentage of gross domestic product*)



Bur	Burma	Jam	Jamaica
Cey	Ceylon	Kor	Korea (Republic of)
Chi	Chile	Mal	Malaysia
CT	China (Taiwan)	Mau	Mauritius
Col	Colombia	Mex	Mexico
Cos	Costa Rica	Pan	Panama
Ecu	Ecuador	Par	Paraguay
Gha	Ghana	Phi	Philippines
Gua	Guatemala	R&N	Rhodesia and Nyasaland
Hon	Honduras	Sud	Sudan
Ind	India	Tha	Thailand
Ira	Iran	Tri	Trinidad and Tobago
Isr	Israel	Uru	Uruguay

Source and foot-notes: *See* tables I-3 and I-7.

GOVERNMENT SAVING

As most developing countries tend to be deficient not only in physical infra-structure, but also in entrepreneurial and managerial skills and in many of the institutions necessary for modernizing the economy, governments often find it necessary to go beyond the formulation of general policies and plans and the provision of the ordinary public services required to stimulate and support higher growth rates. In order to accelerate the development process, they often participate actively in the establishment and operation of various financial intermediaries designed to promote saving and investment and even the production facilities themselves. The financial involvement of governments in most developing countries thus extends beyond the raising of revenue to sustain the conventional administrative services; it includes a good deal of direct financing of investment in the duly enlarged public sector, as well as the provision of institutions and funds to direct and facilitate investment in the private sector.

Notwithstanding the additional responsibilities which devolve on governments in the developing countries, their share in the national product has, in general, been substantially below that common in the more advanced countries. In very few of the latter is the ratio of tax revenues to gross domestic product less than one-fourth, and in some it is in excess of one-third. Among the developing countries, by contrast, there are few governments in receipt of more than one-fifth of the gross domestic product; the average ratio is probably in the vicinity of 15 per cent, and there are many in which government income constitutes less than one-eighth of the country's output.

It is clear that in general the additional claims on government that arise because of the inadequacies of the private sector in most developing countries are more than offset by the absence of the need—or public pressure—for many of the functions performed by governments in the more complex societies of the higher-income countries. In many developing countries the subsistence sector is more or less self-contained and imposes minimal demands on government services. And many of the activities growing out of the necessities of more advanced technology—in the administration of laws relating to traffic, patents, factory safety and so on—have not yet begun to encumber the budgets of most developing countries. However, even among the services that have, with varying degrees of comprehensiveness, to be provided by all governments, the relative costs are still much lower in the developing countries.

One reason for the disparity lies in the coverage and complexity of the social security system in many of the more advanced countries. But income transfers absorb a sizable proportion of government revenue in many developing countries, too: in 1962-1964, for example, they accounted for over 3 per cent of gross domestic product in such countries as Bolivia, Chile, Ecuador, Israel and Mauritius (*see* table I-4). Another reason for the higher government share in resources in the more advanced countries is their

Table I-4. Developing countries: Government disposable income and its components, average 1962-1964[a]

(Percentage of gross domestic product)

Country[b]	Government disposable income[c]	Direct taxes			Indirect taxes minus subsidies			Net transfers[d]	Other income
		Total	Household	Corporate	Total	Indirect taxes	Subsidies		
Venezuela	22	9	1	8	9	9	—	—1	6
Federation of Malaya	21	6	3	3	13	13	—	—	2
Israel	20	10	8	2	13	17	4	—4	1
Ecuador	18	7	4	3	9	9	—	—4	6
China (Taiwan)	17	2	1	1	12	12	—	—	3
Jordan	16	2			9	..		2	3
Burma	15	4	..	..	10	10	—	—	2
Rhodesia and Nyasaland	15	10	4	7	5	6	—	—2[e]	2[f]
Mauritius	15	5	3	3	12	12	—	—3	1[g]
Costa Rica	14	4	3	1	9	10	1	—1	1
Trinidad and Tobago	13	6	1	5	5	6	1	—1	3
Chile	13	11	8	3	8	10	2	—7	1
Panama	13	5	3	2	7	8	—	—	—
Jamaica	13	6	3	3	9	9	1	—2	—
Republic of Viet-Nam	13	1	—	1	12	12	—	—	—[h]
Republic of Korea	12	3	3	1	7	7	—	—	1
Ghana	11	3	1	2	9	10	—	—1	—
Philippines	11	4	2[i]	2	8	8	—	—1[i]	—[j]
Tanganyika	11	4	..	..	6	6	—	—1	1
India	10	3	2	1	7	8	1	—[k]	—
Colombia	9	4	2	2	5	6	—	—1	1
Honduras	9	1	—	1	8	8	—[l]	—	—
Bolivia	9	4	4	1	7	8	1	—4	1
Guatemala	9	2	1	1	7	7	—	—	1

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Yearbook of National Accounts Statistics*.

[a] For certain differences in time period and concepts, *see* foot-notes to table I-2.

[b] Countries are arranged in descending order of percentage of disposable income to gross domestic product.

[c] Disposable income of government is the current income available for the purchase of goods and services. It is defined as the sum of direct and indirect taxes and other incomes, minus subsidies and net transfers to households and private non-profit institutions. Disposable income excludes transfers to and from abroad.

[d] Net transfers are shown with a reversal of sign as a deduction from government income.

[e] Including net transfers to public corporations.

[f] No imputation is made for the rental value of government buildings.

[g] Including depreciation.

[h] Excluding income from general government entrepreneurship and interest on the public debt.

[i] Current transfers from household sector are included in direct taxes.

[j] Including savings of public corporations.

[k] Including some capital transfers.

[l] Subsidies include net losses of public enterprises.

relatively greater defence expenditures. But in this area, too, some developing countries carry a relatively heavy burden: in 1962-1964 defence absorbed over 2 per cent of the gross domestic product in such countries as Ecuador, the Federation of Malaya, India and Tunisia, and over 5 per cent of the gross domestic product in China (Taiwan), Jordan, the Republic of Korea and the Republic of Viet-Nam. A further factor tending to limit the relative size of public revenues is the general weakness of local and provincial authorities in many of the developing countries. Some of the functions performed professionally by such authorities in the more advanced countries are carried out privately or co-operatively in the developing countries—or not at all.

At the root of the matter, however, is the difficulty that confronts governments in almost all the developing countries in raising the required revenue. Despite the relative modesty in their levels of public consumption—exceeding one-eighth of gross domestic product in only a small minority of cases—the developing countries have found it very hard to achieve an adequate surplus on current account from which to finance public investment. In the period 1962-1964, for example, comparatively few of the developing countries for which data are available were able to save more than 2 per cent of their gross domestic product by collecting revenue in excess of government consumption expenditure (*see* table I-5).

In most developing countries, thus, the government contribution to the savings ratio of 15 to 20 per cent of gross domestic product implicit in the growth target is a very small one. Nor has it been increasing in recent years: on the contrary, between 1953-1955 and 1962-1964, the proportion of governments managing to raise their net saving rates was only half that of those in which there was a decline. And the reductions in rates were generally significantly greater than the increases (*see* table I-6).

The tendency for government saving rates to decline reflects the failure of revenue collections to keep pace with the rise in consumption. Claims on government services have been increasing rapidly, and almost everywhere the proportion of national output absorbed in government consumption is materially higher than it was ten years ago. On the revenue side performance has been much less uniform: a few countries have registered appreciable increases in the relative size of the income at the disposal of government, but in many there has been no advance, and in a significant proportion government disposable income has lagged well behind the growth in production.

The problem is not likely to diminish. Indeed, as indicated above, the need to raise the quantity and quality of government-provided services—in such fields as education and health, in particular—will tend to become more urgent as urbanization and industrialization proceed. In some cases, indeed, the failure of governments to increase their activities will itself tend to retard the development process: there is a great need to devote more resources to research in agriculture, for example, to improve the utilization of water and tropical soils, and in many countries changes in land delimitation and tenure are priority items for public expenditure to raise productivity in a crucial sector. If a government is to meet these needs and at the same time increase its contribution to the country's saving in the interest of continued growth, a major challenge to public financial administration lies ahead.

The challenge is a dual one. On the one hand there is the need to make public expenditure as productive as possible, both in terms of functional priorities and in terms of administrative efficiency. On the other hand is the need to increase govern-

Table I-5. Developing countries: Level of general government net saving, average 1962-1964[a]

(*Percentage of gross domestic product*)

Country[b]	Net saving	Disposable income[c]	Consumption
Venezuela	9	22	13
Federation of Malaya	6	21	15
Ecuador	5	18	13
Chile	3	13	10
Trinidad and Tobago	3	13	11[d]
Jamaica	2	13	10
Burma	2	15	13
Colombia	2	9	7
Rhodesia and Nyasaland	2	15	13
Guatemala	2	9	7
Costa Rica	1	14	13
India	1	10	9
Philippines	1	11	10
Panama	1	13	12
Bolivia	—	9	9
Ghana	—	11	11
China (Taiwan)	—	17	17
Honduras	—	9	9
Uruguay	—	12	13
Tanganyika	—1	11	11
Republic of Korea	—1	12	13
Israel	—1	20	21
Republic of Viet-Nam	—9	13	21
Jordan	—9	16	25

Source: See table I-2.

[a] For certain differences in time period and concepts, *see* foot-notes to table I-2. For Ghana, the data refer to the central Government only.

[b] Countries are arranged in descending order of percentage of net government saving to gross domestic product.

[c] As defined in table I-4.

[d] Including interest on the public debt.

Table I-6. Developing countries: Changes in levels of general government saving, consumption and disposable income between 1953-1955 and 1962-1964[a]

(Percentage of gross domestic product)

Country[b]	*Net saving*	*Consumption*	*Disposable income*	*Total tax receipts*	*Direct taxes*			*Indirect taxes*		
					Total	*Household*	*Corporate*	*Total[c]*	*Taxes*	*Subsidies*
Israel	2	2	5	8	3	2	—	4	5	1
Republic of Korea	2	2	5	4	1	1	1	2	2	—
Chile	2	—	2	5	2	2	—	2	3	1
Ecuador	2	—	2	2	3	1	2	—1	—2	—
Trinidad and Tobago	1	—1	—1	—2	—	—	—1	—	—1	—1
Jamaica	1	2	2	4	3	1	1	1	2	—
India	—	2	2	3	1	—	1	2	3	—
Philippines	—	2	2	3	2	1	1	1	1	—
Mauritius	—	2	2	3	—1	—	—1	4	4	—
Panama	—1	1	—	1	1	1	—	—	—	—
China (Taiwan)	—1	—	—1	—2	—1	—	—	—1	—1	—
Honduras	—2	2	—	—	—	—	—	—	—	—
Guatemala	—2	1	—1	—	—	—	—	—1	—1	—
Colombia	—2	—	—2	—2	—	—	—	—2	—2	—
Uruguay	—3	3	—	2	3	3	—	—1	—1	—
Rhodesia and Nyasaland	—3	4	1	1	—	1	—1	2	1	—
Costa Rica	—3	4	—	1	1	1	—	—	—	—
Ghana	—4	3	—1	1	1	1	—	—	—	—
Barbados	—4	4	—	—2	—1	—	—1	—	—1	—1
Burma	—5	3	—2	—3	—			—3	—3	—

Source: See table I-2.

[a] For certain differences in time period and coverage, *see* foot-notes to tables I-2, I-3 and I-5.

[b] Countries are arranged in descending order of change in percentage of net saving to gross domestic product.

[c] Indirect taxes minus subsidies.

ment income with the least possible detriment to private saving.

On both sides the government faces awkward choices. In principle, savings can be generated at any level of income, and indeed in practice—as table I-5 indicates—saving ratios of 2 per cent of gross domestic product or more have been achieved not only by governments with relatively high revenues (Ecuador, the Federation of Malaya and Venezuela, for example), but also by governments with relatively low revenues (such as Colombia and Guatemala), while zero or negative saving rates have been registered by governments with high revenues (China (Taiwan), Israel and Jordan, for example), as well as by governments with low revenues (such as Bolivia, Ghana, Honduras and Tanganyika). But it is clear that if in fact governments in the developing countries are going to be faced with steadily increasing claims for services and their consumption expenditure gradually rises towards the levels common among the more advanced countries, then their most difficult problems will lie on the income side.

In most developing countries, governments depend very largely on indirect taxes for their income. This is in part a reflection of the historical role played by taxes on goods moving either in or out through customs. It also reflects the administrative difficulties of collecting direct taxes from a low-income population that is often geographically scattered and not always sufficiently integrated into the money economy to make contributions in cash. Of the twenty-four countries listed in table I-4 the only ones to collect more from direct than from indirect taxes were the four major mineral exporters—Chile, Rhodesia and Nyasaland, Trinidad and Tobago, and Venezuela—where it is relatively easy to administer profit and income taxes on the exporting companies and their personnel. Thus, even in these cases, tax receipts tend to vary with the volume and price of the exports of a particular commodity. This is also true of much of the item classified as "other income": apart from fees and licences, and interest and rental receipts, this includes royalties on minerals exported, profits on government monopolies handling particular commodities (some of which are major exports or imports) and gains made on foreign exchange control operations.

While the possibility of taxing export activities, either directly or indirectly, has been a great advantage to most developing countries, providing revenue at minimal administrative inconvenience and cost, undue dependence on such taxes is not without risk. When the exported commodity has to be sold competitively on the world market, the rate at which a specific tax can be levied is obviously limited, particularly if the developing country has itself to compete for foreign capital to operate the industry. And if the tax is not specific but linked to price or profit, the yield is subject to the short-term fluctuations on the commodity market and possibly to a longer-term deterioration in the relative price level. During the period under review, it was this downward drift in prices that contributed significantly to the tendency for the relative importance of exports of goods and services in total production to decline in a majority of developing countries (*see* table A.I-1 in the annex to this chapter).

As a corollary to this, it was only in a minority of countries that the yield of indirect taxes increased more rapidly than total production in the ten years ending in 1964 (*see* table I-6). This is not to argue for a reduction in the dependence of developing countries on direct taxes; on the contrary, it points to the conclusion that if a government is to obtain additional income from indirect taxes, their type and incidence may have to be widened so as to lessen the share of export taxes in the total.

On the whole, taxes on imports seem likely to suffer from a shrinking base. The development process—through the growth of import substituting industries on the one hand and the need to conserve foreign exchange in order to acquire essential investment goods on the other—tends to change the composition of imports in a way that reduces their suitability for collecting revenue-raising customs duties. Imports are often subject to other forms of control and the high-priority items are often admitted duty free in order to hold down local costs of investment or production.

In principle, the process of development should itself facilitate the raising of revenue by means of direct taxes. The extension of the money economy, the rise in personal incomes, the evolution of new income-earning entities and the improvement in public administration—all closely associated with the development process—should make it possible for governments to win approval for tax policies designed to place a larger share of total output at their disposal. Recent evidence tends to bear this out: there is a distinct tendency for the relative magnitude of direct tax revenue to rise with the country's average *per capita* income (*see* figure VI).

Thus, although indirect taxes still provide the bulk of government income in a majority of developing countries, there is a widespread tendency for the relative contribution of direct taxes to increase. In the ten years ending in 1964 there were, among the countries for which data are available, very few registering a significant decline in the proportion of government revenue derived from direct taxes (*see* table I-7).

The feasibility of collecting direct taxes is strongly influenced by the distribution of income. By and large, in low-income countries the more equal the distribution, the more difficult it is likely to prove to increase the contribution of direct taxes. In many developing countries, however, the pattern of income distribution is in fact notably askew, so that direct tax rates, if appropriately progressive, may sometimes be raised to the advantage of both government revenue and social justice.

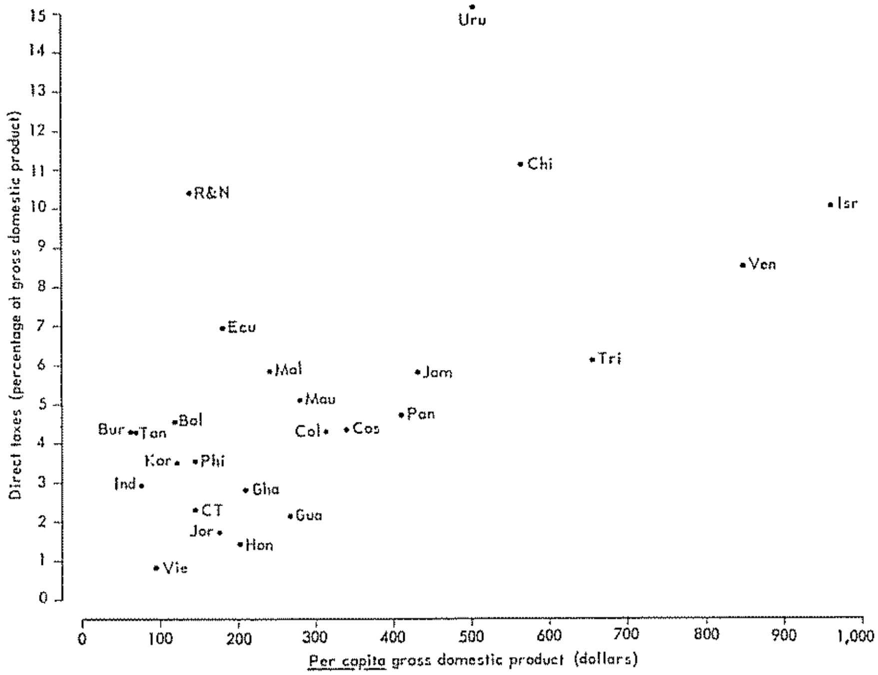
Direct taxes can also be levied on companies, and in general the more important the corporate sector, the more readily can such taxes be administered and increased. The limitation here arises from the fact that companies are themselves major generators of savings, and on a longer view governments may wish to avoid a tax policy that could impede the growth of the corporate form of organization. Up to now, moreover, the largest corporate contributors to the tax revenue have been the exporting concerns under foreign ownership, so that there has been a pronounced tendency for direct corporate tax receipts to vary with export returns (*see* figure VII).

With one or two exceptions where the corporate form of organization has become more prevalent in recent years—Colombia and Ecuador, for example, and, on a relatively smaller scale, India and the Republic of Korea—the corporate contribution to direct taxes has not shown any significant tendency to increase. On the whole, the gain in the importance of direct taxes seems to have come chiefly from the profits of unincorporated business and from personal incomes.[2]

Generalizing on the basis of the limited statistical evidence available, it would appear that the trend in recent years has been away from taxes based on foreign trade and towards those based on income or wealth or on internal transactions (*see* table I-8). The need to widen the tax base has been universally recognized and a good deal of experimentation has been taking place. Local sales or purchase taxes or excise taxes on goods of mass consumption, though not always the most equitable form of impost, are being more generally adopted in order to exact some contribution to government revenue from incomes

[2] Further analysis is impeded by the fact that in current national accounting conventions the personal and unincorporated business sectors are combined in a so-called "household" sector.

Figure VI. Developing countries: Relation between general government direct taxes and *per capita* gross domestic product, average 1962-1964



Bol	Bolivia	Jor	Jordan
Bur	Burma	Kor	Korea (Republic of)
Chi	Chile	Mal	Malaysia
CT	China (Taiwan)	Mau	Mauritius
Col	Colombia	Pan	Panama
Cos	Costa Rica	Phi	Philippines
Ecu	Ecuador	R&N	Rhodesia and Nyasaland
Gha	Ghana	Tan	Tanganyika
Gua	Guatemala	Tri	Trinidad and Tobago
Hon	Honduras	Uru	Uruguay
Ind	India	Ven	Venezuela
Isr	Israel	Vie	Viet-Nam (Republic of)
Jam	Jamaica		

Source and foot-notes: *See* tables I-2 and I-7.

that are too low to justify a more direct method of taxation. In some countries this form of local commodity tax has been instituted through government involvement in the distribution process itself: the profits of government monopolies dealing with low-elasticity commodities such as salt, matches, rice, kerosene and electricity have become a significant item of revenue.

Governments have also been able on occasions to derive income from entities the prime purpose of which was price stabilization. Where these have dealt with export commodities their profits have tended to fluctuate violently, depending upon the difference between a varying world market price and a firm producer price, usually guaranteed to local farmers at the beginning of the crop year. Though in this case the critical variable has usually been the external price, the fruitfulness of official monopolies as revenue raisers depends on local decisions about prices. Here governments often face a dilemma: while their growth policies require increased profits, revenue and saving, their social and stabilization policies have often called for the holding down of local consumer prices. In many cases, indeed, the government involvement in the distribution of goods and services has resulted in losses rather than profits.

Apart from the extension of internal commodity taxes administered in various ways, governments in developing countries have been experimenting with taxes on wealth, including land and capital gains and inheritances. Some have also been attempting to enlarge the off-take from income taxes by reducing the range and magnitude of exemptions and abatements and increasing their progressivity, especially at the higher-income levels.

Table I-7. Developing countries: Level of government total tax receipts and components, average 1953-1955 and average 1962-1964[a]

Country[b]	Total tax receipts		Indirect taxes		Direct taxes					
					Total		Corporate		Household	
	1953-1955	1962-1964	1953-1955	1962-1964	1953-1955	1962-1964	1953-1955	1962-1964	1953-1955	1962-1964
	(Percentage of gross domestic product)		(Percentage of total tax receipts)							
Uruguay	25	27	52	44	48	56	2	3	46	53
Israel	19	27	62	63	38	37	7	6	31	31
Chile	16	21	45	47	55	53	18	14	37	39
Mauritius	14	17	58	71	42	29	23	15	19	14
Rhodesia and Nyasaland	15	16	30	35	70	65	51	43	19	22
Ecuador	14	16	76	57	24	43	8	20	16	23
Jamaica	11	15	71	62	29	38	18	22	11	17
China (Taiwan)	16	14	83	84	17	16	9	8	9	8
Costa Rica	14	14	73	70	27	30	14	10	13	20
Burma	17	14	75	69	25	31				
Ghana	12	12	84	78	16	22	14	13	1	10
Trinidad and Tobago	14	12	54	50	46	50	37	38	9	12
Panama	12	12	64	61	36	39	15	13	21	26
Philippines[c]	9	12	79	70	21	30	10	13	11	17
India	8	11	68	73	32	27	5	9	27	18
Republic of Korea	7	11	72	67	28	33	3	7	25	26
Colombia	12	10	64	57	36	43	14	19	22	25
Honduras	9	9	85	84	15	16	10	11	5	5
Guatemala	9	9	78	76	22	24	7	7	15	17

Source: See table I-2.

[a] For the following countries, the earlier period differs from that indicated: Federation of Malaya, Ghana and Uruguay, 1955-1957; Rhodesia and Nyasaland, 1954-1956; India, 1953/54-1955/56 (fiscal year beginning 1 April). For other differences in time periods, *see* foot-notes to table I-2.

[b] Countries are arranged in descending order of percentage of total tax receipts to gross domestic product for 1962-1964.

[c] Current transfers from household sector are included in direct taxes

It is clear that much greater efforts will be required not only in devising new methods of raising revenue, but also in improving the administration of older taxes, including the reduction of collection costs and of the opportunities for evasion. The expansion in revenue is needed in the first instance to meet the growing claims on governments for the many collective services associated with—and in some cases essential to—the process of economic development. But, as suggested above, the need extends beyond keeping up with government consumption as such; it also involves the economy's saving. The importance of government saving is inversely related to the capacity of the private sector to save. Herein lies one of the main criteria by which the economic efficiency of the tax system may be judged in the present context. As far as possible the incidence of taxes should be on private consumption; for development purposes their objective should be the maximization of saving for the economy as a whole rather than merely for the public sector.

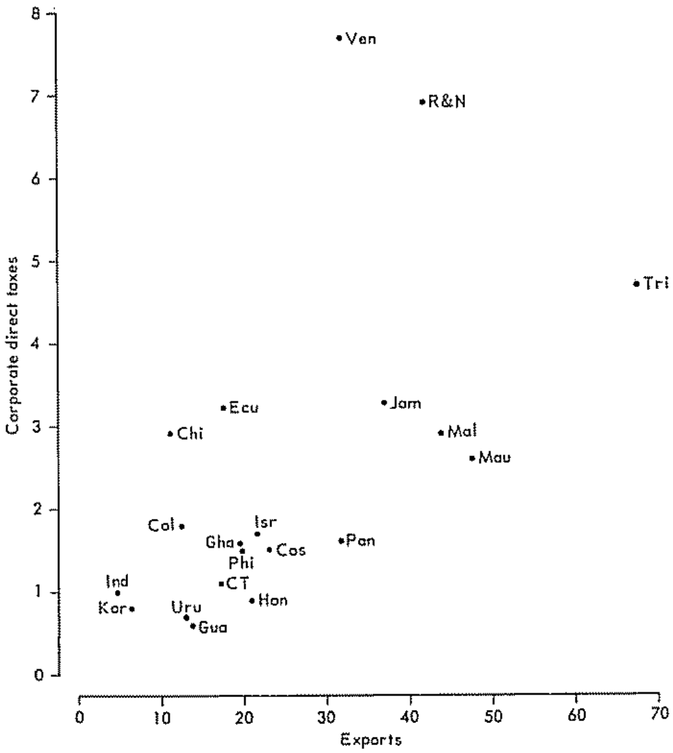
From this point of view, the need for the government to achieve a current surplus in order to finance investment in the public sector may be diminished by adequate increases in saving propensities in the private sector. These saving propensities reflect private decisions about the disposal of income—personal or business—but official policies exercise an important influence on such decisions. From the point of view of the country's economic development, however, the increase in private savings is not an end in itself: the use of such savings in a manner that is consonant with national investment priorities is no less important. Consequently the government's role in regard to the mobilization of domestic savings is not only a matter of budgetary management and the relation of public consumption to public revenue. It extends, partly through the fiscal system, but also through credit policies and the establishment or supervision of institutions, to the provision of a legal, political and economic environment conducive to the financing of an appropriate rate and direction of investment.

SAVING IN THE PRIVATE SECTOR

In most countries the bulk of saving is done in the private sector. This reflects the fact that the

Figure VII. Developing countries: Relation between corporate direct taxes and exports, average 1962-1964

(Percentage of gross domestic product)



Chi	Chile	Jam	Jamaica
CT	China (Taiwan)	Kor	Korea (Republic of)
Col	Colombia	Mal	Malaysia
Cos	Costa Rica	Mau	Mauritius
Ecu	Ecuador	Pan	Panama
Gha	Ghana	Phi	Philippines
Gua	Guatemala	R&N	Rhodesia and Nyasaland
Hon	Honduras	Tri	Trinidad and Tobago
Ind	India	Uru	Uruguay
Isr	Israel	Ven	Venezuela

Source and foot-notes: *See* table I-4.

private sector consists not only of individuals, who are essentially consumers of the goods and services produced in the economy, but also of business enterprises the chief motives of which include the earning of profit which can be used to replace and expand capital equipment. In a general analysis of this nature, there is no means of statistically separating personal saving from business saving, but the available evidence suggests that in most developing countries the latter constitutes a far larger contribution than the former to total domestic saving available for productive investment. In some countries, indeed, including some with widely different economic structures—Chile, Colombia, Ecuador, Jamaica, Panama, the Republic of Korea and the Republic of Viet-Nam, for example—the corporate business sector alone has furnished the bulk of private saving in recent years (*see* table I-9). And in most countries, the business sector consists very largely of unincorporated enterprises.

The problem of mobilizing private saving is a dual one. On the one hand is the question of increasing business savings and facilitating their most effective deployment. On the other hand is the task of stimulating individuals to save more and to make their savings available for the financing of appropriate growth-promoting investment. Both aspects of the problem are urgent, for though the increases in net saving ratios achieved in the ten years ending in 1964 came largely from the private sector (*see* table I-10), the expansion of private saving has been insufficient in all but a few developing countries to compensate for the indifferent record of governments as savers. If national saving rates are to

Table I-8. Developing countries: Components of central government revenue, average 1953-1955 and average 1962-1964

(Percentage of total revenue)

Country[a]	Year[b]	Taxes on income and wealth	Taxes on foreign trade: Total[c]	Import taxes	Export taxes	Taxes on internal trans-actions[d]	Other revenue[e]
Israel	1953-1955	38	21	21	—	32	9
	1962-1964	44	14	14	—	33	10
Chile	1953-1955	34	13			35	18
	1962-1964	37	18			40	5
Panama	1953-1955	25	27			14	34
	1962-1964	27	28			23	22
Costa Rica	1953-1955	19	57	52	5	15	10
	1962-1964	20	56	51	5	11	12
Colombia	1953-1955	42	31			11	16
	1962-1964	49	20			24	7
Guatemala	1953-1955	9	53	..	.	30	8
	1962-1963	11	41	32	9	40	9
Ghana	1956-1957	11	73[c]	31	33	2	15
	1963-1964	16	57	37	14	13	14
Honduras	1953-1955	16	53	50	4	27	4
	1962-1964	14	50	45	5	26	10
Ecuador	1953-1955	12	46	40	7	34	8
	1962-1964	14	52	39	13	22	13
Philippines	1953-1955	16	33	33	—	37	13
	1962-1964	22	23	23	—	41	13
Rhodesia and Nyasaland	1954-1955	59	15			4	21
	1961-1962	56	19			4	21
Republic of Korea	1957-1958	25	20[c]	16	—	46	8
	1963-1964	20	15	15	—	45	20
India	1955-1956	19	25	20	5	23	32
	1963-1964	22	17	16	—	32	30
Burma	1953-1955	22	25			12	42
	1962-1964	28	26			26	20

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Statistical Yearbook*.

[a] Countries are arranged in descending order of *per capita* gross domestic product in 1963.

[b] Calendar years, except in the case of the following countries: Burma, fiscal year ending 30 September; Ghana, fiscal year ending 30 June for 1956-1957 and fiscal year ending 30 September for 1963-1964; India and Israel, fiscal year beginning 1 April; Philippines, fiscal year beginning 1 July.

[c] Including other taxes on foreign trade: Ghana, including cocoa marketing board grants and mineral duty, which accounted for 8 per cent of total revenue in 1956-1957 and 6 per cent in 1963-1964; Republic of Korea, including foreign exchange levies, which accounted for 4 per cent of total revenue in 1957-1958.

[d] Including excise and sales taxes and profits of fiscal monopolies. For the Philippines, including, excise duties on exports.

[e] Includes charges and fees for services, royalties, rents and other income from property, income from land sales, interest received and the like. For Israel, including profits of government trading enterprises (which accounted for one per cent of total revenue in each of the periods); for the Republic of Korea, profit of government enterprises accounted for 2 per cent of total revenue in 1957-1958 and 5 per cent in 1963-1964; for India, the percentages were 18 per cent in 1953-1955 and 14 per cent in 1963-1964; for Burma, profits of state agricultural marketing board (mainly from rice) and state timber board accounted for 31 per cent in 1953-1955 and 5 per cent in 1962-1964.

increase, it is from the private sector that the resources ultimately have to come.

MOBILIZING PERSONAL SAVINGS

In most cases personal savings are of a residual nature: they arise from what is left of the individual's income after his basic consumption needs (and those of the family for which he is responsible) have been met. The main stumbling-block to the increase in such savings is thus the low level of personal incomes that prevails in developing countries: almost 90 per cent of the population live in countries in which the average *per capita* output in 1963 was less than $200, and about two-thirds in countries with an average of less than $100 (*see* table A I-2 in the annex).

Table I-9. Developing countries: Level of domestic saving, by sector, average 1962-1964[a]

(*Percentage of gross domestic product*)

Country[b]	Gross domestic saving	Net domestic saving	Net government saving[c]	Private saving: Total	Private saving: Net corporate saving[d]	Private saving: Net household saving
Venezuela	23	13	9	4	2	3
Federation of Malaya	20	15	6	9		
Trinidad and Tobago	19	9	3	7	1	6
Burma	18	12	2	10		
Rhodesia and Nyasaland	18	12	2	9	4	5
China (Taiwan)	18	11	—	11		
Colombia	16	6	2	4	3	2
Jamaica	15	8	2	6	5	1
Philippines	15	9	1	8	3	5
Ecuador	14	9	5	4	3	1
India		10	1	8		
Uruguay	13	10	—	10	1	9
Honduras	12	7	—	8	2	5
Chile	11	3	3	1	3	—4
Costa Rica	10	5	1	4	1	3
Bolivia	9	3	—	3	1	2
Guatemala	8	4	2	2		
Panama	8	3	1	2	6	—4
Israel	8	—1	—1	—		
Republic of Korea	6	1	—1	2	3	—1
Republic of Viet-Nam	—4	—9	—9	—	2	—2
Jordan	—6		—9	3	—	3

Source: See table I-2.

[a] For certain differences in time period and concepts, *see* foot-notes to table I-2.

[b] Countries are arranged in descending order of gross domestic saving ratio.

[c] Net government saving includes saving of general government and government enterprises However, for Ecuador and the Philippines, government saving also includes saving of public corporations. For China (Taiwan), government saving includes saving of general government only.

[d] Net corporate saving includes saving of public and private corporations. For Ecuador and the Philippines, it is saving of private corporations only.

Empirical studies of income, expenditure and savings patterns suggest that while at the lowest levels of income dis-saving is common, as income rises both the amount and the proportion saved tend to increase, at least up to the highest income brackets where other influences—often deriving from foreign consumption standards—sometimes tend to depress savings rates.

The negative rates of saving reported among low-income households in Ceylon (1963), India (1960-1962) and Thailand (1963) (*see* table A.I-3 in the annex), as well as among working-class families in Bombay (1958-1959), British Honduras (1958) and the Philippines (1957)[3] reflect not only the claims for food, clothing and shelter and similar physical essentials, but also a certain amount of socially determined expenditure sometimes arising from religious or ceremonial practices that tend to characterize the more rigidly structured rural societies. Some of the latter claims on income may be expected to weaken with the modernization and monetization of the agrarian sector, but it is unlikely that saving rates will benefit, for the process tends to expose the rural population to new products and the demonstration effect of the expenditure patterns of urban and higher-income communities.

This is not to say that saving is impossible in low-income households. Some saving is in fact achieved; what is needed is to increase its amount and to change its form from the accumulation of physical assets, such as jewellery and cattle, to the accumulation of financial assets, realizable by the saver but also usable for the purpose of productive investment. This involves a change in customary

[3] International Labour Organisation *Yearbook of Labour Statistics, 1964* (Geneva)

Table I-10. Developing countries: Changes in net domestic saving between 1953-1955 and 1962-1964[a]

(Percentage of gross domestic product)

Country[b]	*Domestic saving*	*Government saving*	*Private saving*		
			Total	*Corporation*	*Household*
Philippines	8	—	8	1	7
Jamaica	7	1	7	3	4
China (Taiwan)	6	—1	7		
Chile	3	2	1	—2	3
Mauritius[c]	2	—	3	—	3
Panama	2	—1	3	5	—2
Israel	2	2	—		
India	2	—	2		
Uruguay	2	—3	5	—	5
Republic of Korea	—	2	—2	4	—6
Trinidad and Tobago	—	1	—1	—	—1
Ecuador	—	2	—2	1	—3
Guatemala	—1	—2	2		
Honduras	—1	—2	—	2	—1
Colombia	—3	—2	—	1	—2
Costa Rica	—4	—3	—1	—	—
Rhodesia and Nyasaland	—4	—3	—1	—3	2
Burma	—5	—5	—		

Source: See table I-2

[a] For certain differences in time period, *see* tables I-2 and I-3

[b] Countries are arranged in descending order of percentage change of net domestic saving to gross domestic product.

[c] Including depreciation.

attitudes and behaviour and the building up of institutions capable of performing the required function.

The problem is a more difficult one in the rural areas than in the towns: not only are rural incomes generally lower and, with agricultural production lagging, rising more slowly than urban incomes, but household structure and customs tend to be less conducive to saving. The extended family provides some of the economic security which in the more atomistic urban society is sought through saving: thus the savings of the more fortunate members tend to be consumed by the less fortunate. In many places land tenure systems are inimical to saving and investment, sometimes because of smallness of plots or uncertainty of rights deriving from the tenant-landlord relationship,[4] sometimes because of lack of individual incentives stemming from the communal nature of holdings.

The change in habits necessary to stimulate saving can be accelerated by education, but its pace is also dependent on the monetization of the economy, and in this the extension of appropriate institutions is itself an important instrument. Recent history seems to point to security and convenience as the strategic attributes of any institution that is to mobilize the savings of individuals. To inspire confidence in the minds of potential savers, the institution must have a record of reliability and this can be attained only on the basis of experience over time. But acceptable sponsorship helps to speed up the process and, limited as they have been, the successes that have been achieved in the post-war period have been confined very largely to co-operative societies (in which local members participate in management), government savings banks and old-established commercial banks whose name has become a household word. The main handicap of co-operative societies has usually been the scarcity of effective management, while the commercial banks have often been deterred by the unprofitable nature of the required expansion, especially in the early years, when the local branch services—especially in the rural areas—are rarely used to the extent necessary to make them economic. Even governments have found it necessary to use entities already in existence—most notably the network of post offices—in order to bring the required facilities close enough to the potential savers to satisfy

[4] A low level of saving by tenants is not necessarily offset by a high level of saving by the landlord, especially when the latter does not farm the estate, for the system does not promote technical advance and improvements in productivity, and very seldom does the income accruing to the landlord contribute to development finance

the second criterion mentioned above, namely saver convenience.

Where private facilities are available, their efforts to attract savings have sometimes been assisted by the provision by government of a system of guarantees or insurance for the savings deposits they accept. Increasingly, however, even unsophisticated small savers have become concerned not only with the traditional concept of security—that is, being able to get back at will all the money that has been saved—but also with the purchasing power of what is retrieved. The process of encouraging the switch from physical to financial assets is set back, or even reversed, by inflation.[5] And even in a relatively stable economy, recent experience suggests that personal saving in developing countries tends to respond positively to changes in rates of interest, especially after the basic precautionary slice of saving has lessened the urgency of the security motivation. An increase in individual savings has followed a rise in the relevant interest rate in a number of countries—including Mexico and Peru, as well as India, Pakistan and the Philippines. An alertness to changes in interest rates has been noted even in relatively unsophisticated communities. In a number of African countries, for example, the recent growth of savings deposits in commercial banks has been ascribed in part to the fact that the rates of interest that were offered were appreciably higher than those payable on post office savings, which have in consequence been languishing. While interest rate differentials may give rise to the switching of deposits more than to an increase in new saving, the fact that there is such a response has encouraged governments to use the interest incentive more freely in efforts to encourage individuals to raise their rate of saving.

Apart from higher interest rates, other devices have been used to stimulate personal savings. The disincentive effects of inflation have been counteracted in some places by the insertion of a gold or cost of living clause in the savings contract; the Government of Israel, in particular, has borrowed a good deal on this basis. Other countries have sought to attract saving and overcome the negative effect of local inflation by the introduction of a lottery element into savings instruments: thus Ghana and India and several Latin American countries have issued savings bonds which earn for their holders not only a rate of interest, but also the possibility of winning prizes in periodical lottery drawings. The chance of windfall gains has been made a feature of certain insurance schemes in El Salvador and Guatemala and of certain house-building savings schemes in Mexico and Uruguay.

Schemes which link savings more closely with equity participation in business enterprises also help to overcome the reluctance to save that stems from the erosive effects of inflation. This has been the basis of so-called mutual funds and unit trusts in many countries, particularly in Latin America—Argentina, Chile, Colombia and Mexico, for example—but also in India and Pakistan. These schemes have generally succeeded best (in attracting small savings) where a capital market was already functioning well, for where the cost of reaching the savers is unduly high or the difficulty of making appropriate investments and managing a share portfolio unduly great, the attraction of an equity holding may be offset by high costs of administration.

Where the degree of development of corporate enterprise is sufficiently great, similar advantages may be derived from a liberalization of the regulations governing various special-purpose funds that are fed by personal savings. The return on pension funds and endowment types of insurance can be made significantly more attractive if the investment policy of the trustees is not too narrowly circumscribed. As saving habits can be seriously set back by the failure of such funds, however, restraint on the part of the trustees and supervision by the authorities are both essential to success. Recent experience suggests that since sound investment possibilities tend to widen as the process of economic development advances, the operating rules for such investment activities need to be kept up to date and, if small savings are to be encouraged, in line with the realities of the market.

Insurance and pension funds involve the type of saving that is of particular importance to developing countries, namely, contractual saving. This tends to provide a regular and predictable flow of resources for investment during the actuarial growth of the particular fund and more generally with the expansion of the economy. In a few countries—Mexico, for instance—mutual investment funds have also been set up on the basis of the agreement of participants to make periodic contributions. Contractual saving of this nature has been a corner-stone in the building up of a capital market in a number of countries, and everywhere it is one of the principal ways in which individuals of modest means participate in the financing of industry.

Contractual saving is also involved in the liquidation of debt. This often endows credit institutions

[5] For the community as a whole, a certain amount of price inflation—provided it is of a limited nature and not chronic or accelerating—may in fact increase total saving: it may reduce the consumption of those whose incomes are fixed in money terms and raise the proportion of total income distributed as profit, and hence to those who generally have relatively high saving ratios. As far as voluntary personal saving is concerned, however, the effect of inflation seems to be negative.

with important savings functions. Building societies, for example, may finance various forms of construction, particularly residential, for members who have saved sufficiently for a required down payment and whose future savings are then earmarked for the repayment of the loan. In most countries such societies also have authority to accept deposits from other savers, thus acting as a financial intermediary for a certain type of investment. In much the same way, co-operative savings banks have enjoyed the greatest success when they have been associated with, or even preceded by, a credit-providing role, as has been the case in a number of African countries. In agrarian communities, in particular, co-operatives have tended to stimulate local saving most when they have been able first to provide short-term credit or help in the financing of farm improvements.

Government policy thus impinges on private saving in many ways. The establishment of appropriate lending institutions may itself serve as an important stimulus of the saving of those who borrow. The maintenance of an adequate but adaptable system of control over deposit-receiving institutions is also an important function. Its fiscal mechanisms are no less relevant and can usually be designed to bear less heavily on income that is destined to be saved than on consumption. A knowledge of the saving rate profile of the community would be helpful. The apparent tendency for saving rates to decline at the highest levels of personal income might suggest that an upward turn in the progressivity of the income-tax at the indicated level would permit an increase in public saving at minimum cost to private saving.

The prevalence of low-income levels tends to slant the fiscal structure towards indirect taxes, but there are occasions on which a suitably designed system of direct taxes on personal incomes can divert windfall gains to the public good without upsetting traditional consumption standards: some of the benefit of a bumper crop or of the sudden rise in the price of an export commodity on the world market—which might be used for prestigious consumption if left in the hands of the producer—could be captured for government saving, for compulsory private saving or for a stabilization fund.

The individual's investment and savings pattern can also be influenced by the outlays that are allowed to rank as deductions from taxable income. The deduction from taxable income of interest payments on loans for certain purposes, for example, may serve to encourage particular types of investment—in residential construction in some countries, in agricultural improvements in many others—and consequential saving by the individual concerned.

More important than marginal adjustments of tax structure in the present context is the contribution that governments can make towards improving the climate for personal saving. The promotion of economic growth in general is obviously the prime necessity for raising saving rates, and along with this is the avoidance of undue inflation and the provision of the appropriate institutional framework, especially in the rural areas where the combination of low incomes and traditional patterns of consumption militate strongly against the expansion of saving.

Somewhere between the stagnation of the traditional village and the social disorganization of rapid townward migration lies the middle ground of progressive adaptation of older patterns of income use. Here, self-help and community development, land tenure reform and the judicious use of credit—if necessary from savings generated in other sectors—for productivity-raising investment in agriculture seem, on the basis of post-war experience, the basic requirements for a long-run increase in personal saving rates in most developing countries. But the difficulties should not be underestimated, for this is the hard core of the development problem, and in most countries rural investment rates have in fact been raised only when savings from other sources could be deployed for the purpose.

MOBILIZING BUSINESS SAVINGS

While the saving effected by individuals and by governments is in many ways incidental—a diversion of resources from the basic activity of consumption—the saving performed by business enterprises is central to their main purpose. Though statistical proof is lacking, the available evidence points to reinvested profits not only as major means of expanding the productive capacity of individual firms, but also as a leading source of domestic saving. In the present context the questions most germane to the problems facing the developing countries are how to raise the rate of increase in the net revenue of the business sector and how best to influence the distribution of that revenue in order to ensure its optimum use in accordance with national investment priorities.

The raising of the rate of increase in profits is not an objective that can be pursued on its own: like the question of raising the level of personal income referred to in the previous section, it is part of the general problem of accelerating the pace of economic development as a whole. But there are certain aspects of the question that pose choices—in respect of both economic policy and institution building—likely to exercise a powerful influence on the environment in which profits are earned and used.

Policies regarding prices and wages lie outside the scope of the present discussion, though they are the area of some of the most acute dilemmas facing governments that are seeking to achieve an income distribution that is both socially just and conducive to higher saving rates. More immediately relevant are the steps taken to canalize savings to where investment is to be financed. And one of the first decisions to be made concerns the deployment of business profits.

The profit earned in a business enterprise may move in any of three ways—to individual owners of the firm as dividends, to the government as tax and to the reserves of the firm itself. In so far as fiscal policy is designed to maximize domestic savings, tax rates can be adjusted to influence the movement towards the points of highest saving rate. Recent experience suggests that the optimum rate structure for the purpose has to be shaped in the light of the disincentive effect on future profit earning of unduly high tax rates on the one hand, and of the saving propensities of the potential recipients of dividends on the other. As indicated above, it has been largely through higher levies on the net earnings of business that governments have increased their direct tax revenue. Where a well-conceived development plan exists, this provides a convenient means of canalizing savings into public sector investment.

The use of both retained earnings and distributed dividends is strongly influenced by the investment opportunities open to the parties concerned. While, in general, profits retained in the business are most likely to be reinvested in the expansion of the firm, it is by no means certain that this always represents the most productive use of the savings in question. More productive investment might in fact result if the profits were distributed, but only if the recipients have high savings ratios and are able to use the available mechanisms for financing development: a judgement on this would have to be made on the basis of the known characteristics of the local capital market.

Indeed, in its broadest sense, the capital market is a major determinant of the efficacy of business saving and investment. For on its smooth operation depends the ability of the small family-type firm that characterizes many developing countries to obtain the capital necessary for expansion. And conversely, it is only if the appropriate institutions are functioning satisfactorily that small individual savers are able to contribute to the financing of investment.

THE EVOLUTION OF THE CAPITAL MARKET

The post-war period has witnessed a good deal of improvement in the working of capital markets in developing countries. In general the advances have been most noticeable where development itself has been greatest: there is a close and mutually reinforcing connexion between economic growth, industrialization and income levels on the one hand, and the internal generation and movement of capital on the other. The areas in which changes are most apparent are those relating to the organization of business enterprises as such and those relating to the evolution of financial intermediaries. Though in both areas the developments have benefited the generation of saving—and are likely to do so increasingly as time passes—the principal feature has been their role in canalizing savings to selected sectors for the financing of particular forms of investment.

The main advance in business organization has been the spread of corporate forms. This has hinged on the adoption of an appropriate legislative framework. The details of this vary from country to country and often need to be changed to keep abreast of technological as well as economic and institutional developments. But the essential function that is fulfilled by the corporate structure is that of facilitating the pooling of savings for a common enterprise. The limitation of the liability of shareholders to the amount outstanding on the shares, by enlarging the number of potential participants in business finance, extends very greatly the capital "watershed". This is particularly important in places where savings are small, business often organized around a family unit and productivity held down by lack of capital. The possibility of building larger units, which is opened up as the system of corporate entities becomes established, has implications not only for production but also for future saving.

It is significant that among the countries for which data are available, corporate saving exceeded government saving in 1962-1964 in three out of four cases (*see* table I-9). And over the ten years ending in 1964, corporate saving in most developing countries for which data are available increased at least as fast as total production (*see* table I-10). Where it did not, it was often because higher taxes absorbed a greater proportion of corporate income, though in some cases—Chile, and Rhodesia and Nyasaland, for example—the savings of the corporate sector were strongly influenced by changes in world prices and in the profits of export industries.

The corporate form of business has served not only to bring small personal savings into the capital market, but also to facilitate the formation of "mixed" companies in which government may participate along with private shareholders, or foreign capital along with domestic capital—private or public or both.

The full benefit of corporate organization can be reaped only under an appropriate legal and fiscal régime. Particularly important in developing countries, where impersonal business relations are less common and innovations often suspect, is the safeguarding of the shareholder's position, especially in the initial stages when small savers are being invited to participate in a corporate venture. Recent experience suggests that, if the development of the local capital market is to be encouraged, it is also important to prevent corporate taxes—usually among the most productive and easiest collected in developing countries—from getting far out of line with other forms of direct taxation. On the one hand, as suggested above, the savings-generating function that corporate entities perform can be fostered by appropriate treatment of reinvested earnings: if the interests of the economy as a whole are to be served, tax rates need to be determined in the light of savings and investment propensities and intentions of both government and the corporate sector. On the other hand, the return that an individual saver may obtain from participation in corporate enterprises is itself an incentive to future saving, provided it is not unduly depressed by high tax rates. Taxation is not the only means that governments have for obtaining resources for investment: the more effectively the capital market is operating, the more readily are governments likely to be able to borrow.

Both the ability of governments to tap personal savings and the growth of corporate enterprise on the basis of extensive participation depend heavily on the size and efficiency of the local securities market. Herein lies one of the characteristic weaknesses of the financial structure in developing countries: as a result of the unequal distribution of incomes and the relative infrequency of financing by corporate issues, in very few cases is ownership of shares or bonds sufficiently widespread, or the mechanism for exchanging them sufficiently smooth or inexpensive to make the basic instruments of the capital market liquid enough for the purpose of attracting small savings. Even in countries in which there are organized stock exchanges—about eleven in the early nineteen sixties—the bulk of the trading in securities is often done outside, on a bilateral basis: governments tend to place their bonds privately with institutions, and directors frequently prefer to keep the ownership of their companies within a limited circle of family and friends. The result has been an extremely high concentration of shareholding—in Colombia, for example, three-fourths of all outstanding shares are owned by less than one per cent of all shareholders—which is inimical to the saving-mobilizing function of the market.

Efforts to increase the usefulness of the securities market in mobilizing savings have been made by governments both in connexion with their own financial operations and with a view to influencing the financial activities of corporations. Some governments (India, Mexico and Nigeria, for example) have diversified the range of the obligations they themselves has sought to sell to the public—varying denominations, raising interest rates, attaching tax privileges, providing a gold link or an equity component or the chance of a windfall gain. By short-term borrowing on 30 to 90-day bills—to bridge budgetary gaps, for example—governments have also opened up a money market in several developing countries, relieving them of the need to turn to the central bank, absorbing temporarily idle funds and adding a useful element of flexibility to the local capital market. Legislation has been enacted in such countries as Colombia, India, Mexico and Venezuela to induce or compel corporations to offer their new issues on the open market. Some countries have also relaxed the regulations governing the nature of the assets that savings banks, insurance companies and other deposit-collecting institutions are permitted to hold, thus widening the market for equities. In a number of countries, development finance entities, both public and private, have tried to spread as widely as possible the sales of securities from their own portfolios, effected in the course of their regular operations. They have also pioneered in the provision of an underwriting service—thus assisting corporations to tap the supply of local savings—though in most cases this has also involved them in a direct investment operation.

These and similar efforts have borne some fruit, especially in those developing countries where economic diversification is greatest and incomes are highest. Everywhere, however, the basic fact of capital shortage tends to limit progress, and while the creation of new institutions and changing the rules under which older institutions operate may help to move savings more freely—and thus make it possible to use to maximum advantage the savings that are generated—the process of increasing saving rates is clearly going to be a long and hard one.

Illustrative of the nature of the problem is the history of the institution that represents the most widely adopted innovation for the financing of investment in the developing countries in the post-war period, namely, the "development corporation". A variety of such instruments now exists, bearing different labels but performing essentially similar functions. Some are government-sponsored, some privately sponsored and some under mixed auspices.[6] Some are general-purpose entities (such as

[6] The distinction between a public and a private institution tends to be blurred by the fact that most of the latter have in fact enjoyed official support and help to implement official development policy. The support has often been in the form of an advance of funds (sometimes interest free), but it has also included preferential tax treatment, preferential

the Banco del Estado in Chile and most of the development banks in Africa), others are designed to move capital to particular sectors, most notably manufacturing industry (such as the International Finance Corporation of India), but also farming (as in the case of the Agricultural Development Bank of Pakistan), and in some countries housing and other special fields in which investment needs are running ahead of available saving. Most are national in scope, but some are intended to serve particular geographic regions such as the Guyana Development Corporation in Venezuela or the Banco del Norte, which operates through branches in the Brazilian north-east. Some are entirely domestically financed, others draw funds from external sources, including in particular the IBRD and the IFC, but also the IDA and the IDB, and a number of national agencies such as the Caisse centrale de Coopération économique in France, the Commonwealth Development Corporation in the United Kingdom and the Agency for International Development (AID) in the United States. These institutions —especially the IBRD—have found development corporations a convenient means for facilitating the movement of funds to individual enterprises which it might otherwise be administratively difficult or legally impossible for them to reach (*see* table A.I-4 in the annex). By the end of 1965, the IFC had an equity investment totalling $16.5 million in development finance companies in the developing countries while the IBRD had lent almost $300 million to similar institutions.

These development corporations have played an important role in canalizing funds to sectors and projects which—often because of deficiencies in the capital market—have been unable to obtain them in the course of ordinary business in the developing countries. They have thus in many cases become useful operational agencies in the implementation of economic plans. They have often exerted a catalytic effect by mobilizing matching finance from local savings. They have also provided a convenient route for the flow of external resources into the domestic economy, though even in the case of the private corporations foreign holdings have usually been of a minority nature (*see* table A.I-5 in the annex).

In general, the development corporations have been lenders rather than investors. Rates of interest have tended to be high by international standards—mostly between 7 and 12 per cent a year—but low by local standards. The size of single loans or investments has usually been limited by their charter to a specified range, either absolutely or in relation to their capital, so that their involvement in individual projects has often been small by external standards, though not necessarily by local standards. In many cases their involvement has extended beyond the simple loan transaction in which it is expressed. Thus many of these entities have had at their disposal entrepreneurial and managerial skills that are particularly scarce in most developing countries, so that financing operations have often been associated not only with preliminary management and accounting appraisals and market research, but also with technical assistance and advice, including the provision of expertise from abroad. In addition, the involvement has usully created links of a more permanent nature, important both to the enterprise in question in connexion with its future expansion or diversification and to the functioning of the local capital market. The latter has also gained from the transactions arising out of the subsequent handling by the development corporations of the assets in their security portfolio: the judicious selling of these may help to make additional savings available for investment. Enlargement of the corporations' own capital—by sale of debentures, for example—may also be expected to strengthen the capital market and attract new savings.

It has been in this last area that the greatest disappointments have occurred. By and large, development corporations have been much less successful in generating new saving than they have been in canalizing existing resources into enterprises of their choice. Even some of the oldest entities—and the Corporación de Fomento in Chile dates back to 1939—have remained disturbingly dependent on resources fed to them from other public sources, including in particular the central bank and the government's own budget. Though, almost invariably, the original intention was that the development institution should become self-supporting as its revenue—from interest on loans, from profits on equity investments and from sales of various technical services—increased and its portfolio of securities was turned over, in practice this has seldom happened.

One reason for the widespread failure of these institutions to attain an early viability was the initial concentration in some cases on relatively unremunerative investment in infra-structure—including transport, communications and power undertakings which were subsequently run at a loss—and in other cases on difficult sectors, such as agriculture and small-scale industry in which investment had to be financed on a subcommercial basis. Another reason has been the general dearth of resources, especially where, as part of its development strategy, a country established several such bodies, each requiring a sizable

central bank discounting facilities, and official guarantees on external borrowing. In some cases, governments have even guaranteed a minimum dividend in order to attract the necessary local capital.

flow of funds to sustain its investment programme. The inadequacy of the available finance often tended to reduce the effectiveness of investment policy, both in respect of the type of enterprise the corporation supported and in respect of the operations of the resultant undercapitalized concerns. In many cases the management of the institution was not sufficiently strong to cope with the rapid proliferation of its interests. And underlying these problems in many countries was internal economic instability: it is difficult to make long-term lending profitable when it is conducted on more or less commercial terms in a strongly inflationary environment.

While, as a new instrumentality, development corporations have generally been less successful than had been hoped in stimulating new saving, adaptations made by a much older institution—the commercial bank—have been unexpectedly fruitful. The commercial bank has several important attributes as a collector of savings in most developing countries: a solid reputation for financial integrity, an extensive network of branches, an experienced staff, many and close links to the business community, to the capital market and often to external sources of finance, and a functioning system for dealing with deposits, both current and time, and in many countries with savings accounts too. What the commercial bank has chiefly lacked in the present context is the connexion with long-term investment. In most countries, commercial banks have continued to perform their essential historical role, providing short-term accommodation, especially in the financing of trade. This requires a high degree of liquidity in asset structure, often prescribed by the central bank as one of the mechanisms of monetary control.

In the post-war period, however, there has been a significant extension and expansion of commercial bank activities. This has rested in part upon a more active policy in regard to the gathering of savings, spurred in some countries—Chile, India, Mexico, Morocco, Pakistan, and Tunisia, for example—by the setting up of government-owned banks, and it has involved an enlargement of branch business, even in the smaller towns and villages, and greater efforts to attract deposits. That this has recently been bearing fruit is indicated by the fact that in many countries, the nineteen sixties have seen a rapid rise in their savings and time deposits: in real terms (that is, allowing for local changes in the retail price level) such deposits have increased at over 15 per cent a year in a diverse range of countries, including Mexico, Peru, the Federation of Malaya, Pakistan and the Philippines, and significant numbers of African countries—Ghana, the Ivory Coast, Nigeria, the Sudan and the United Arab Republic.

Simultaneously, changes have been taking place in investment activities also. These reflect in part the search for new and more profitable ways of using funds, and in part the continuous rise in demand for finance associated with more active official development policies. The result has been an increase in the amount of financing of fixed assets and in the amount of longer-term bank lending, sometimes on the basis of the regular renewal or "rolling over" of short-term advances. The changes in operating methods have also led to the establishment or acquisition by commercial banks of subsidiaries dealing specifically with the financing of longer-term investments. In some places, most notably in Latin America, these new entities (*financieras*) have engaged directly in the collection of savings through the issue of special securities (*cedulas*).

Commercial banks have also participated in the setting up of development corporations such as those discussed above, both with local interests and with international and other external institutions. Links have been forged not only with investing entities —including mortgage banks as well as development companies—but also with institutions involved more directly in collecting savings, such as building societies and insurance companies. Such groupings of complementary organisms have served to strengthen the financial structure of a number of countries, though sometimes at the cost of reducing the free flow of savings and securities through the capital market.

Commercial banks have also widened their investment interests in response to official directives and incentives. One device employed in a number of countries—Chile, India, Nigeria and Peru, for example—is the offer of special central bank rediscount facilities and rates for loans made to specific sectors or for specific purposes, including agriculture, small-scale industry and low rental housing which are almost invariably short of investible funds. In some instances—including Colombia, India, Pakistan and Venezuela—refinance corporations have been set up in order to provide the commercial banks with the means of maintaining the necessary degree of liquidity. A similar effect has been obtained in some countries—Colombia and Mexico, for example—by the stipulation of marginal reserve requirements differentiated in accordance with the sector or purpose for which the commercial bank has extended its credit. More directly, governments have induced commercial banks to hold various types of public securities, thus putting loanable funds directly into official hands.

The harnessing of commercial bank funds to the development effort is one aspect of a more general effort to tap real savings. Parallel efforts are being made to deploy more usefully the resources accruing to other institutions that collect savings—insurance, pension, social security, building funds and so on. The importance attaching to the activities of commercial banks lies in the fact that they still dispose of the bulk of savings and time deposits in the developing countries.

The role of external resources

To accelerate their rate of economic growth, the developing countries are heavily dependent on the rest of the world. For many of them, given their existing structure of production, an increase in domestic saving rates would, by itself, be of little avail. The pattern of locally available resources is quite inadequate even for sustaining, let alone raising, the rate of fixed capital formation. The most obvious shortages are in the capacity to produce the plant and equipment and materials which are the physical content of investment, but they often extend throughout the economy and include knowledge and skills, many producer requirements, the more sophisticated consumer goods and in some cases even the energy sources and food-stuffs necessary to support greater domestic output and higher levels of income.

It is only by trading with the rest of the world that the developing countries can make good these specific deficiencies and raise their rates of capital formation and *per capita* production. And here another inadequacy makes itself felt: the pattern of goods that most developing countries have available for export is quite unsuitable for providing the steady expansion in earnings necessary for financing the imports required to overcome the domestic bottlenecks. These exports consist very largely of primary commodities, the demand for which is not very responsive to increases in income in the countries that constitute their main market. In some cases they include items that the more advanced countries are reluctant to import in larger quantities lest their domestic producers—farmers and textile workers, for example—be injured by the competition. And in many cases the effect of an inelastic demand is accentuated by an unstable supply, giving rise to considerable fluctuations in price and export receipts.

For most developing countries, the combination of urgent and increasing import needs and slow-growing and uncertain export earnings has resulted in more or less continuous balance of payments strain. In many cases this has been met by constraints on imports—in part, consistent with efforts to diversify the domestic economy by the stimulation of import-substituting industries, but often at the cost of slowing down the pace of growth and making inflationary pressures more difficult to contain. But most developing countries have been spared the full effects of this basic imbalance by being able to draw on resources provided by the rest of the world. Thus, ever since the running down of the reserves they had accumulated during the war, many countries have registered a more or less unbroken deficit on their current accounts—that is, imports of goods and services plus payments for the use of foreign-owned factors of production have continued to exceed exports of goods and services plus receipts from abroad for the use of nationally owned factors of production.

Irrespective of their size in relation to domestic savings, the foreign savings that have been put at the disposal of the developing countries in this way have thus played a strategic role in the development process. Their significance depends not only on the magnitude of the country's current account deficit as such, but also on the extent to which external resources are necessary to overcome the obstacles to growth inherent in the structural deficiencies of the domestic economy.

As indicated in general terms at the beginning of this chapter and in more detail in table I-11, the relative magnitude of foreign savings has varied widely from one developing country to another. At the one extreme are the countries (the Federation of Malaya, Iraq, Mauritius, the Philippines, Tanganyika and Venezuela, for example) in which foreign capital in mines and plantations generates an export surplus that may be used to increase exchange reserves, to repay previous loans, to finance the repatriation of foreign direct investment, to invest on the international capital market, or, as in the case of Kuwait, to make new loans or investments in other developing countries. At the other extreme are the countries which for various historical reasons are peculiarly dependent on the inflow of external resources—Israel, Jordan, the Republic of Korea and the Republic of Viet-Nam, for example—where the intake of foreign savings may exceed the receipts from the export of goods and services or the amount devoted to capital formation.

In between lie most of the developing countries —running deficits on their current accounts with the rest of the world largely because of their efforts to increase their rates of domestic investment. In the ten years up to 1964 such efforts did in fact result in the raising of the ratio of gross capital formation

Table I-11. Developing countries: Foreign saving and gross domestic capital formation,[a] 1953-1955 and 1962-1964

Country[b]	*Gross domestic capital formation as a percentage of gross domestic product*		*Foreign saving as a percentage of*			
			Gross domestic capital formation		*Exports of goods and services*	
	1953-1955	*1962-1964*	*1953-1955*	*1962-1964*	*1953-1955*	*1962-1964*
Israel	31	31	85	75	222	112
Trinidad and Tobago	22	28	16	31	5	13
Tunisia	..	22	..	55	..	64
Thailand	16	20	15	9	13	11
China (Taiwan)	16	20	38	10	77	11
Colombia	17	19	8	19	9	35
Jamaica	15	19	53	17	28	8
Rhodesia and Nyasaland	29	19	24	1	14	—
United Arab Republic	..	18	..	23		24
Venezuela		18		—24	..	14
Burma	21	18	—7	1	—7	1
Federation of Malaya	11	18	—81	—10	—19	—4
Ghana	15	17	13	25	8	22
Mauritius	14	17	—41	—30	—12	—10
Panama	11	17	38	51	12	27
India[c]	8	13	4	24	5	54
Ecuador	15	17	12	18	9	17
Republic of Korea	13	16	57	62	239	143
Bolivia	..	16	..	43	..	38
Paraguay	14	16	9	11	10	10
Sudan	10	16	—1	21	..	17
Costa Rica	18	15	18	35	12	23
Uruguay	15	15	10	10	32	12
Mexico	14	15	4	11	4	15
Jordan		14		145		134
Philippines	8	14	29	—5	17	—4
Ceylon	10	14	—36	16	—10	8
Honduras	15	14	8	12	5	8
Iran	..	14	..	7	..	5
Iraq	16	14	—33	—10	—11	—3
Chile	8	13	1	19	1	23
Morocco		12		11	..	6
Tanganyika		11		—9		—3
El Salvador	..	11	..	2	..	1
Guatemala	9	11	1	26	1	23
Republic of Viet-Nam		10		141		195
Average, all developing countries[d]	15	16[e]	12	13[e]	11	12[e]

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Yearbook of National Accounts Statistics*, and International Monetary Fund, *Balance of Payments Yearbook*, vol. 16 (Washington, D.C.).

[a] For certain differences in the period covered see table I-3, foot-note *a*.

[b] Countries are arranged in descending order of ratio of gross domestic capital formation to gross domestic product in 1962-1964

[c] Ratios are based on net domestic capital formation.

[d] Including estimates for countries not shown; based on 1960 prices and exchanges rates

[e] Average, 1961-1963.

to gross domestic product in a large majority of countries and by proportions ranging up to 6 or even 7 per cent (as in the Federation of Malaya, Panama, the Philippines, the Sudan, and Trinidad and Tobago). And associated with this, in most cases, was an increase in the relative significance of the inflow of external resources. Only a few countries —China (Taiwan), Jamaica, the Philippines and Thailand among them—managed simultaneously to raise their rates of capital formation and reduce their dependence on foreign savings. And at the other end of the scale were a few countries—including Burma, Costa Rica and Honduras—in which investment ratios declined in the face of an increase in the relative contribution of foreign savings or, in the case of Iraq, a reduction in the current account surplus.

In the aggregate, foreign savings at the disposal of the developing countries seem to have increased erratically in the post-war period to a peak around 1956-1958, when they constituted about 4 per cent of the over-all gross domestic product and about 25 per cent of gross capital formation. Since then foreign savings have increased less than production or investment, and by 1963 their ratio to gross domestic product had dropped below 2 per cent and their ratio to gross capital formation to below 10 per cent. Not unrelated to this decline was the slackening in the growth of investment: this rose by over 6 per cent a year during the nineteen fifties, but by less than 4 per cent in the first four years of the nineteen sixties.

The concept of "foreign savings" that emerges from the national accounts provides a useful measure of the degree of dependence of the country on resources furnished by the rest of the world. For operational purposes, however, it is more useful to trace the changes in this dependence through the movements in the principal variables concerned. It then appears that the recent decline in foreign savings had its origin in the efforts made by the developing countries to narrow the gap on trading account that had widened rapidly in the second half of the nineteen fifties. This gap had pulled down the combined external resources of the developing countries to a dangerously low level.

Though efforts continued to be made to expand exports, the main constraining action by governments was the tightening of import controls. Largely as a result of these, the rate of growth in imports in the first half of the nineteen sixties was held down to an average of less than 4 per cent per year, compared with over 5 per cent per year in the nineteen fifties. In the event, relief for the balance of payments also came from the export side: thanks largely to more vigorous growth in North America and a continuation of the upswing in other industrial countries the export earnings of the developing countries increased by an average of between 6 and 7 per cent per year. As a result, the combined trading deficit of the developing countries, which had stood at $3.4 billion in 1961 was reduced to about $0.5 billion in 1965.

The net inflow of long-term capital and donations from the rest of the world continued to increase slowly—at an average of approximately 3 per cent per year, reaching an estimated $9 billion in 1965. Thus, notwithstanding a rising burden of dividends and interest on earlier borrowings—probably in the vicinity of $5 billion in 1965—and a variable but probably quite sizable outflow of indigenous capital, the developing countries were able to replenish their external reserves to the extent of about $1.2 billion. This still left the ratio of total international liquidity (gold plus foreign exchange plus available borrowing facilities at the IMF) to current imports—at about 31 per cent—slightly below the 1960 level and well below earlier levels.

If they are to achieve a higher rate of growth in the supply of goods and services available to their expanding populations, the developing countries will have not only to save and invest relatively more, but also to be able to finance the necessary increase in imports. While the longer-term objective must obviously be to finance the required imports by means of their exports, it is clear that in the years immediately ahead most developing countries will continue to depend heavily on other types of resource transfer. The nature and magnitude of these transfers will be influenced by the fact that the reverse flow necessary to service the debt accumulated in the past will continue to rise rapidly. This means not only that the gross transfer must be large enough to assure an adequate net inflow of new resources, but also that the terms on which these resources are provided should be such as to prevent the problem of reverse debt-servicing flows from compounding itself into completely unmanageable proportions. It also means that every effort should be made to ensure that the nature of the transfer and the form in which it is made are governed by the priorities dictated by a sound development strategy in which the external resources can be deployed with maximum effect to complement internal efforts to increase savings, investment and growth.

Annex

Table A.I-1. Developing countries: Levels and changes in levels of exports of goods and services, 1953-1955 to 1962-1964

(Percentage of gross domestic product)

Country[a]	Change in exports, 1953-1955 to 1962-1964	Exports 1953-1955[b]	Exports 1962-1964[c]
Ceylon	—9	37	28
Iraq	—8	48	39
Ghana	—8	27	20
Barbados	—7	58	51
Rhodesia and Nyasaland	—6	48	42
Burma	—6	22	16
Mexico	—5	16	10
Federation of Malaya	—4	48	44
Syria[d]	—3	31	27
Costa Rica	—3	27	23
Brazil	—3	8	6
Panama	—2	34	32
Uganda	—2	32	29
Dominican Republic	—2	26	24
Sudan[e]	—2	19	17
Colombia	—2	14	12
Thailand	—2	19	17
Ecuador	—2	19	17
Morocco	—2	23	21
India[d]	—1	6	5
Pakistan	—1	7	7
Venezuela[e]	—	32	32
Nigeria[d]	—	19	18
Honduras	—	21	21
Guatemala	—	14	14
Algeria	1	24	25
Mauritius	1	46	48
Trinidad and Tobago	1	66	68
Jordan	2	14	16
Chile	2	9	11
Tanganyika	3	26	30
Argentina	4	6	10
Uruguay	4	9	13
Peru	4	21	25
Paraguay	4	13	17
Republic of Korea	4	2	6
Kenya	5	16	21
Philippines	6	14	20
Jamaica	9	28	37
China (Taiwan)	9	8	17
British Guiana	10	43	53
Israel	10	12	22

Source: United Nations, *Yearbook of National Accounts Statistics* and *Statistical Bulletin for Latin America*

[a] Countries are arranged in ascending order of percentage change of exports of goods and services to gross domestic product

[b] For the following countries, the period differs from that stated: Jordan, Peru, and Rhodesia and Nyasaland, 1954-1956; Ghana, the Federation of Malaya, the Sudan (fiscal year beginning 1 July) and Uruguay, 1955-1957.

[c] For the following countries, the period differs from that stated: Burma (fiscal year ending September), Brazil, Colombia, the Dominican Republic, Iraq, Pakistan (fiscal year beginning 1 July), Syria, Trinidad and Tobago, and Uruguay, 1961-1963; Algeria, British Guiana, Nigeria (fiscal year beginning 1 April), Panama, the Sudan (fiscal year beginning 1 July), Uganda, and Argentina, 1959-1961.

[d] For India and Syria, net domestic product at factor cost. For Nigeria, gross domestic product at factor cost.

[e] For the Sudan and Venezuela, exports of goods only.

Table A.I-2. Distribution of developing countries[a] by *per capita* output, 1963

Per capita *gross domestic product (dollars)*	*Number of countries*	*Population (percentage)*
100 and below	22	64
101 to 200	20	22
201 to 300	15	6
301 to 500	10	5
501 and over	7	4
Total	74	100

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Yearbook of National Accounts Statistics* and *Monthly Bulletin of Statistics*; and United States Agency for International Development, *AID Economic Data Book* (Washington, D.C.).

[a] Countries in each category are as follows (in ascending order of *per capita* gross domestic product in dollars): 100 and below: Malawi, Somalia, Ethiopia, Guinea, Laos, Burma, Mali, Uganda, Nepal, Tanganyika, Haiti, Togo, India, Indonesia, Kenya, Afghanistan, Pakistan, the Malagasy Republic, Cameroon, the Sudan, the Republic of Viet-Nam, and Sierra Leone; 101 to 200: Thailand, Cambodia, Bolivia, the Republic of Korea, Ceylon, China (Taiwan), the Philippines, Morocco, Syria, Libya, Saudi Arabia, the United Arab Republic, Jordan, Ecuador, Tunisia, Algeria, Paraguay and Brazil; 201 to 300: Honduras, Senegal, Ghana, the Ivory Coast, Southern Rhodesia, Iran, Peru, Gabon, El Salvador, the Dominican Republic, Guatemala, Iraq, Nicaragua, Mauritius, the Federation of Malaya and British Guiana; 301 to 500: British Honduras, Colombia, Lebanon, Costa Rica, Barbados, Mexico, Surinam, Panama and Jamaica; 501 and over: Uruguay, Chile, Argentina, Trinidad and Tobago, Venezuela, Israel and Kuwait.

Table A.I-3. Ratio of household saving to disposable income by income class: Sample surveys for selected countries[a]

(Percentage)

Income class (percentage of total households in sample survey)	*Ceylon (1963)*	*India*		*Mexico, urban (1960)*	*Thailand*[b]	
		Rural (1962)	*Urban (1960)*		*Rural (1963)*	*Urban (1963)*
Lowest 20	—21	—6	—21	0	—19	—33
Next 20	—13	—3		8	—20	—24
Next 20	—8	0	—8	14	—14	—7
Next 20	—7	2	—5	19	7	—14
Next 5	—6	5	—1	27		
Next 5	—6	6	0			
Next 5	1	9	7			
Next 3	3	10	11	22	2	23
Next 1	12	19	18			
Highest 1	6	16	33			
Average, all households[c]	—4	5	3	14	—16	—2

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on data from Central Bank of Ceylon, *Survey of Ceylon's Consumers Finances* (Colombo, 1963); National Council of Applied Economic Research, *All India Rural Household Survey*, vol. II (New Delhi, 1965) and *Urban Income and Saving* (New Delhi, 1962); National Statistical Office, *Household Condition Survey* (Bangkok, 1964); Secretaria de Industria y Comercio, *Las 16 Ciudades Principales de la República Mexicana: Ingresos y Egresos Familiares, 1960* (Mexico, D.F., 1962).

[a] Disposable income consists of earned income, property income and net transfers from government and other sectors, less direct taxes. The income is gross in the sense that no allowance was made for depreciation of capital, except in India, where the net concept was used. In India and Thailand, savings were measured by estimating changes in assets, including changes in stocks, while in Ceylon and Mexico, savings were measured as the difference between income and consumption. Expenditure on durable consumer goods was not included in saving in Mexico or, except for housing and jewellery, in Ceylon.

[b] The data available for Thailand do not permit a classification of the saving ratios according to the income classes shown. The saving ratios cited in the table correspond to the following income classes:

Income category (bahts per year)	*Rural*	*Urban*
	(Percentage of households)	
Less than 3,000	64	80
3,000 to 5,999	33	10
6,000 to 11,999		
12,000 to 17,999		
18,000 and over	3	10

[c] The sample sizes, in number of households surveyed, were as follows: Ceylon, 5,399; India, rural, 8,527; India, urban, 4,650; Mexico, 1.67 million; Thailand, rural, 69,956; Thailand, urban, 161,259. The averages are ratios of total savings to total income.

Table A.I-4. Loans by the International Bank for Reconstruction and Development to development corporations

Country	Name of institution	Loan: Year	Loan: Amount (millions of dollars)
China (Taiwan)	China Development Corporation	1964	15.0
Ethiopia	Development Bank of Ethiopia	1961	2.0
India	Industrial Credit and Investment Corporation of India, Limited	1959	10.0
		1960	20.0
		1962	20.0
		1963	30.0
		1965	50.0
Malaysia	Malaysian Industrial Development Finance, Limited	1963	8.0
Morocco	Banque nationale pour le Développement économique[a]	1962	15.0
Pakistan	Pakistan Industrial Credit and Investment Corporation	1959	10.0
		1961	15.0
		1963	20.0
		1964	30.0
Peru	Banco de Fomento Agropecuario del Peru	1960	5.0
		1965	15.0
Philippines	Private Development Corporation of the Philippines	1963	15.0
Thailand	Industrial Finance Corporation of Thailand	1964	2.5
Total, 1959-1965			282.5

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on International Bank for Reconstruction and Development, *Annual Report* (Washington, D.C.)

[a] Jointly with the International Finance Corporation

Table A.I-5. Structure and operations of development finance companies in which the International Finance Corporation has participated

(Millions of units of national currency, except where indicated)

Country and unit of currency	Name of institution and year of establishment	Origin	Resources: Initial: Paid-up capital	Resources: Initial: Loans	Resources: As of December 1964: Paid-up capital	Resources: As of December 1964: Loans	Resources: As of December 1964: Retained earnings[a]	Ownership, 1964: Percentage of shares	Ownership, 1964: Number of shareholders	Operations as of December 1964: Number of projects	Operations as of December 1964: Equity investment	Operations as of December 1964: Loans
Colombia (pesos)	Corporación Financiera Colombiana (1959)	Domestic	10	24	61	168		56	201			
		Foreign	1	1	53	208		44	24			
		Total	11	25	114	376	28	100	225	389	40	290
	Corporación Financiera Nacional (1960)	Domestic	13	11[b]	43	118		58	96			
		Foreign		—[b]	31	66		42	4			
		Total	13	11[b]	74	184	16	100	100		15	187
India (rupees)	Industrial Credit and Investment Corporation of India (1955)	Domestic	35	75	35	275		70	1,738			
		Foreign	15	10	15	495		30	49			
		Total	50	85	50	770	22	100	1,787	328	75	472
Iran (rials)	Industrial and Mining Development Bank of Iran (1959)	Domestic	240	600	240	1,350		60	1,700			
		Foreign	160	780	160	780		40	20			
		Total	400	1,380	400	2,130	47	100	1,720	...	155	1,636
Israel (pounds)	Industrial Development Bank of Israel (1957)	Domestic	4	20	242	73		80	[c]			
		Foreign	—	5[d]	61	58		20	...			
		Total	4	25	303	132	8	100	...	...	16	382
Nigeria (pounds)	The Nigerian Industrial Development Bank (1964)	Domestic	1	2	1	2		...	...			
		Foreign	1	—	1	—		...	...			
		Total	2	2	2	2	—	...	...	19	0.4	1
Pakistan (rupees)	Pakistan Industrial Credit and Investment Corporation (1957)	Domestic	12	30	24	60		60	728			
		Foreign	8	—	16	760		40	53			
		Total	20	30	40	820	12	100	781	59	8	387
Philippines (pesos)	Private Development Corporation of the Philippines (1963)	Domestic	18	—	25	—		...	925			
		Foreign	—	28	—	32		...	...			
		Total	18	28	25	32	4	...	...	20	—	37
Thailand (bahts)	Industrial Finance Corporation of Thailand (1959)	Domestic	4	28	15[e]	48[e]		...	...			
		Foreign	2	—	3[e]	—[e]		...	12			
		Total	6	28	18[e]	48[e]	2[f]	...	..	30	—	15

Source: Centre for Development Planning Projections and Policies of the United Nations Secretariat, based on International Bank for Reconstruction and Development, *Annual Report 1964-65*; International Finance Corporation, *Annual Report*, 1964 and 1965, and *Private Development Finance Companies*, June 1964; and annual reports of companies.

[a] Including reserves.

[b] As of June 1961.

[c] The Israeli Government is the principal shareholder, but it holds only 26 per cent of the voting stock, the bulk of which is held by institutions.

[d] In 1959.

[e] As of September 1963.

[f] As of December 1962.

Chapter II

THE FLOW OF RESOURCES FROM THE DEVELOPED MARKET ECONOMIES

The scientific and industrial revolutions that transformed western Europe during the 300 years between the Renaissance and the First World War created the means for capital formation on an unprecedented scale. They set in motion a pattern of flow from areas in which the ratio of capital to land was high to areas of lower capital density, which culminated, in the nineteenth century, in a massive movement of resources to regions of new settlement —in North America, Oceania and the southern temperate parts of Latin America and Africa—where railway construction was opening up the hinterland. Though this movement—largely in private hands or raised from private lenders—was resumed after the First World War it never again reached the same relative proportions and it was slowed down to a trickle by the Great Depression, the defaulting of debtors and the imbalance between the capacity to produce primary commodities in the less developed regions and the market demand for them in the more industrialized regions.

Though the state of balance in the commodity market was reversed, at least temporarily, by the Second World War, the traditional movement of capital failed to recover to its previous high level. In the early post-war years this reflected the great demand for capital for rehabilitating the war-damaged economies of Europe and Japan. But completion of this reconstruction phase did not liberate vast quantities of capital for deployment in the less developed areas: the more advanced countries continued to absorb the great bulk of the world's savings. In contrast to the course of events in the pre-war period, there was no drying up of capital formation or emergence of an economic nationalism keeping capital within individual countries. Indeed, in virtually all the industrial countries the rate of fixed investment has been maintained at substantially higher levels than those prevailing in the interwar period, and the movement of capital between these countries has rarely been more vigorous.

This failure of flow of private capital to the less developed countries to expand at a rate comparable to that experienced in earlier periods coincided with a rapid upsurge in the demand for capital by those countries. In the wake of a new and widespread determination to raise levels of living—manifested in the United Nations Charter itself—and of a revolution in the communication of ideas and the movement of people, and the breaking of colonial ties, acceleration of the rate of economic growth became a matter of the highest priority in an increasing number of countries. With domestic saving rates very low, the reserves accumulated during the war were soon used up, and with the average unit value of exports declining rapidly from the relatively high levels of the first decade after the war, most developing countries found themselves under constant balance of payments pressure. The availability of external capital soon became a crucial determinant of the rate of development.

In these circumstances governments in the more advanced countries became involved, on a rapidly increasing scale, in questions relating to the movement of resources to the developing countries, both through private channels and through public agencies. Precedent had been set by the massive government effort put into the European Recovery Programme. But the task in the developing countries was not a simple matter of reconstruction capable of being carried out in a relatively short period. It entailed, instead, a radical transformation of the economic structure of most of the developing countries, to enable them to produce enough capital from internal savings to raise investment to the point where total output could be made to rise sufficiently faster than population to provide a tangible and continuing gain in levels of consumption.

Governments in the more advanced countries, having adopted a universally positive attitude towards the movement of capital to the developing countries, were faced with the problem of evolving practical, and politically acceptable, means of encouraging and, when necessary, actually effecting the transfer of resources. Thus, public involvement has resulted both in official stimuli to private flows of various kinds and in a variety of official schemes for lending or donating funds and goods and services.

In respect of private flows, governments have adopted three types of measures. In varying degree they have encouraged direct investment in the developing countries by such means as fiscal incentives and the provision of insurance or other forms of guarantee—against specified non-commercial risks, for example. In varying degree they have opened their domestic capital markets to borrowers from the developing countries, both public and private. And in various ways they have entered the trading arena—to raise the price paid for an import from a developing country above the world market price, for example, or to arrange insurance or guarantees for the credit provided in connexion with export sales.

Direct public involvement has raised a large number of questions not only in respect of the actual magnitude of the transfer and how the government is to obtain the resources, but also in respect of the nature of transfer, its destination, the terms and conditions on which it is made and the physical arrangements for actually administering it. Policies in these matters have been shaped not only by domestic considerations (including, in particular, the size of the capital exporting country, its fiscal structure and budgetary procedures and its balance of payments situation) but also by external conditions and needs, such as the capacity of the recipient countries to service additional debt, the example of other donor countries and their willingness or anxiety to co-ordinate or harmonize their "aid programmes", and the existence of appropriate multilateral machinery for handling the resources to be transferred.

The assumption by governments of reponsibility for the systematic transfer of resources to the less developed parts of the world is a completely new phenomenon in international affairs. To arrange for such transfers has entailed a good deal of institutional and administrative experimentation. This will doubtless continue as new attempts are made to maximize their effectiveness in terms of changing and sometimes conflicting criteria reflecting different combinations of political, economic and humanitarian motives as well as proximate and more distant time horizons. Governments have had an unequal record in persuading their electorates of the wisdom of a regular budgetary allocation for financing these transfers. Various efforts have consequently been made to use budgetary appropriations in a more catalytic fashion—through insurance, guarantee or interest-subsidy schemes, for example, which are designed to draw much larger amounts from conventional private sources of finance. With the acceptance by governments of targets intended to keep the outflow of resources to the developing countries rising in line with the national income, it seems probable that the search for ways and means of using publicly committed funds to tap the capital market will continue.

Recent trends in the flow of resources

The post-war period has seen a considerable change in the nature and magnitude of the flow of resources from the developed market economies to the developing countries. In the early part of the period the flow consisted predominantly of direct private investment and private lending, supplemented by technical assistance and by a certain amount of defence support furnished to selected countries by the United States. As the war-torn economies recovered, the flow was also supplemented by a certain amount of budget support and lending directed to dependent territories and, on an even more selective basis, reparations payments from the Federal Republic of Germany and Japan. The principal element in the flow was the movement of private capital from the United States to Latin America.

This was a period of relatively high prices for the primary commodities that constituted the bulk of the developing countries' exports, of an over-all trading surplus and of high foreign exchange reserves, including accumulated sterling balances usable by agreement. The constraints on development were chiefly the shortage of skills and knowledge and of domestic saving.

As the nineteen fifties advanced the external balance of the developing countries rapidly deteriorated. Export prices declined and import prices inched steadily upwards. With import expenditure rising steeply, the developing countries moved into an over-all trading deficit which expanded to the unprecedented level of $4.5 billion in 1957. With some of the technical assistance received in the first post-war decade beginning to pay off in declining mortality rates, the need to raise investment rates was becoming ever more urgent. Though in the face of the balance of payments crisis of 1957-1958, imports were cut back and more stringent restraints imposed in many developing countries, the group as a whole continued to run a sizable trade deficit. This, plus a growing gap in the factor payments account—reflecting the servicing burden of earlier borrowing and investment—was financed by a sharply rising inflow of capital and donations.

Thus the external contribution to saving increased sharply in the course of the nineteen fifties. Though, as indicated in the previous chapter, this trend was reversed in the nineteen sixties, nevertheless between 1953-1955 and 1962-1964 there were almost three developing countries in which foreign saving had increased in relation to total production for every one in which the role of foreign saving had diminished.

The principal manifestation of this was the upsurge in the flow of resources from the developed market economies. Between 1956 and 1961 the net outflow of loans and grants from the developed market economies—either bilaterally to the developing countries or to the international institutions for use in the developing countries—rose by about 54 per cent, between 4 and 5 times as rapidly as the trade of the developing countries. And the net outflow of public resources—a better reflection of official policies in this matter—more than doubled (*see* table II-1).

This upsurge was accompanied by some redistribution of the burden among the capital supplying countries. The two main contributors, France and the United States, which provided about three-fourths of the total in 1956-1958, were providing less than two-thirds in 1959-1961, while the contribution of many of the smaller sources rose correspondingly. There was a particularly marked increase in the net outflow from the Federal Republic of Germany (to about 8 per cent of the total) and the United Kingdom (to about 11 per cent) and on a smaller scale from Australia, Belgium, Italy and Japan (*see* table II-2).

Table II-1. Developed market economies: Net outflow of resources to the developing countries and the multilateral agencies,[a] 1956-1964

(Millions of dollars)

Year	Total	Public flows			Private flows		
		Total	Bilateral[c]	To the multilateral agencies[b]	Total	Bilateral[c]	To the multilateral agencies[b]
1956	5,279	2,774	2,607	167	2,505	2,479	26
1957	6,514	3,313	3,034	279	3,201	3,001	200
1958	6,494	3,883	3,645	238	2,611	2,170	441
1959	6,134	3,768	3,540	228	2,366	2,162	204
1960	7,177	4,572	3,982	590	2,605	2,420	185
1961	8,109	5,617	4,803	814	2,492	2,390	102
1962	7,533	5,676	5,031	645	1,857	1,627	230
1963	7,351	5,704	5,294	410	1,647	1,685	—38
1964[d]	7,854	5,698	5,271	427	2,156	1,999	157

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on Organisation for Economic Co-operation and Development, *The Flow of Financial Resources to Less Developed Countries, 1956-1963* (Paris, 1964); *Development Assistance Efforts and Policies. 1965 Review, Report of the Chairman of the Development Assistance Committee* (Paris, 1965); International Monetary Fund, *Balance of Payments Yearbook* (Washington, D.C.), and Special Questionnaire issued jointly by the United Nations Secretariat and the International Monetary Fund.

[a] *Developed market economies* comprise Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, Finland, France, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, South Africa, Sweden, Switzerland, United Kingdom and United States. This list differs from that of Group B specified by the United Nations Conference on Trade and Development (UNCTAD) in recommendation A.V.1. by the inclusion of South Africa and the omission of Cyprus, Greece, Holy See, Liechtenstein, Monaco, San Marino, Spain and Turkey. *Developing countries* comprise all countries and territories in South and Central America (other than Puerto Rico), Africa (other than South Africa), Asia (other than mainland China, Cyprus, Japan, Mongolia, North Korea, North Viet-Nam and Turkey) and Oceania (other than Australia and New Zealand). This list differs from that of Group A specified by UNCTAD in recommendation A.V.1 by the omission of Mongolia, South Africa and Yugoslavia.

All figures are net of repayment or repatriation of principal, disinvestment and retirement; they are not net of reverse flows of capital originating with residents of developing countries or of investment income. Government-guaranteed export credits are not included except in so far as they are used and reported under private portfolio investment or other private lending. The data are thus in accord with the definition of long-term capital and official donations adopted by UNCTAD in its recommendation A.IV.2.

[b] Including grants and other contributions, capital subscriptions, repayments of loans made earlier by the agencies to the developed market economies, participations and purchases of bonds (all measured net of repayments to and disbursements in the developed market economies) relating to EDF, IBRD, IDA, IDB, IFC, UNEPTA, UNFC, UNHCR, UNICEF, UNRWA, UNSF, UNTA and WFP. Contributions to the regular budgets of the United Nations and specialized agencies are not included.

[c] Including reinvested earnings, in some cases on the basis of estimates.

[d] Preliminary, based in some cases on estimates, especially for private capital movements.

Table II-2. Developed market economies: Net outflow of resources to developing countries and the multilateral agencies, by country, 1956-1958 to 1962-1964

(*Millions of dollars*)

Country	*Average, 1956-1958*			*Average, 1959-1961*			*Average, 1962-1964*		
	Total	*Public*	*Private*	*Total*	*Public*	*Private*	*Total*	*Public*	*Private*
Australia	43	30	13	89	83	6	90	90	—
Austria	—15	—15	—	—8	—8	—	11	7	4
Belgium	75	17	58	147	83	64	133	87	46
Canada	118	56	62	102	66	36	115	94	21
Denmark	4	4	—	9	3	6	6	6	—
France	1,165	787	378	1,168	874	294	1,189	900	289
Germany (Federal Republic)	332	230	102	543	369	174	523	394	129
Italy	58	46	12	152	44	108	196	68	128
Japan	143	124	19	188	106	82	249	154	95
Netherlands	203	37	166	204	68	136	112	70	42
Norway	2	1	1	3	2	1	14	6	8
Portugal	2	2	—	33	33	—	48	49	—1
Sweden	20	6	14	36	8	28	45	29	16
Switzerland	88	16	72	111	5	106	83	7	76
United Kingdom	574	208	366	776	386	390	597	415	182
United States	3,278	1,778	1,500	3,523	2,523	1,000	4,179	3,301	878
Total[a]	6,097	3,324	2,773	7,138	4,651	2,487	7,578	5,690	1,888

Source: As for table II-1, the foot-notes to which define the flows.

[a] Countries listed, plus Finland, New Zealand and South Africa.

In the period since 1961 the situation has changed very significantly. The total outflow of resources from the developed market economies was sharply reduced in 1962, and by 1965 had not yet regained the 1961 peak.[1] This was closely associated—both as cause and as effect—with the marked improvement that occurred in the trading balance of the developing countries in this period: the continuing slow rise in imports (as well as the rebuilding of depleted reserves) was financed increasingly out of exports which benefited from a reversal in the long downtrend in unit value. But the failure of the net outflow of public resources to rise beyond the $5.7 billion level also reflects decisions and actions on the capital exporting side, influenced not least by the balance of payments situation in some of the major sources of supply.

During this last period, as throughout the post-war period, the outflow of private capital to the developing countries has been characterized by year-to-year fluctuations rather than by growth.[2] It was at its peak in 1957 when a large amount of new petroleum investment was made and it accounted for almost half of the total outflow. It was only half the 1957 figure in 1963, and over the whole period 1956-1964 it constituted only a little over one-third of the total outflow. During this span, indeed, it showed a distinct downward trend—averaging $2.8 billion a year in 1956-1958, $2.5 billion in 1959-1961 and $1.9 billion in 1962-1964.

Since, historically, the movement of private capital has been a major engine of economic development, this absence of growth in a situation in which development policies have been espoused on an unprecedented scale has created special problems. It goes far to explain the expanding scale of public involvement and it has given rise to a continuing search for ways and means of harnessing private capital more effectively to the development needs of the developing countries.

[1] *See* United Nations, *International Flow of Long-term Capital and Official Donations, 1961-1965* (Sales No: 66.II D 3) for a discussion of recent movements.

[2] It should be noted that this outflow of private capital includes the reinvested earnings (often on an estimated basis) of developed market economies' companies operating in developing countries. It probably does not include more than a small fraction of the credit made available to finance trade. This tends to escape the balance of payments record. It is discussed later in the present chapter, on the basis of information regarding that portion of it that is officially insured.

The supply of private capital

By inter-war standards, the international movement of private capital in the post-war period has been vigorous and varied. It has responded both to the rapid growth of world trade and to the opening up of investment opportunities, most notably in the higher-income countries, but also by the development policies pursued by many of the developing countries. The flow has been facilitated by a number of institutional innovations introduced both by national governments and multilaterally.

Measured against other criteria, however, the flow of private capital to the lower-income countries has been less satisfactory. Compared with the movement to low-income, capital-poor areas before the First World War, the recent flow has played a very much smaller role. Compared with the movement of private capital among the high-income countries since the Second World War, the flow to the low-income countries has been relatively small. And compared with the needs of the low-income countries for external capital in the light of their investment plans, their balance of payments situation and their growth targets, the flow has been far from adequate.

In aggregate terms, it has varied erratically from year to year and after increasing fairly rapidly in the first post-war decade, it has since contracted: as indicated above, it averaged one-third less in 1962-1964 than in 1956-1958. This contraction was quite general; only Italy and Japan have registered a significant growth in private capital exports during the past decade.

Though fluctuating in volume, the direction of the flow has been characterized by a certain stability. The main streams have been from the United States to Latin America, from France to the overseas franc area and from the United Kingdom to the developing Commonwealth countries; and over the period 1956-1964 these three sources have accounted for about three-fourths of the total flow. There has also been a continuing concentration, as far as direct investment is concerned, on the petroleum industry. This has led to a sizable flow of capital to West Asia and North Africa, and not only from the three leading exporters. It has also aggravated the short-term instability of the net outflow, for large-scale repatriation of funds has been a marked feature of much of this investment.

The failure of the flow of private capital to developing countries to expand as steadily and rapidly as needs and circumstances dictated has given rise to various types of official action. Not only have governments become increasingly involved in the actual business of transferring resources to the developing countries but in varying degree they have engaged in creating mechanisms and providing incentives to facilitate and encourage the flow of private capital. That these efforts have sometimes been less successful than had been hoped is in part a reflection of conditions in the recipient countries, where there are still many deterrents to the foreign investor. But more recently it also reflects a certain ambivalence that has been injected into the policies of some of the major capital supplying countries by their individual external payments situations: imbalances among the more advanced countries have tended to inhibit further efforts to stimulate the outflow of capital to the developing countries.

Privately owned resources have moved from the high-income countries to the lower-income countries in three principal ways—through various types of lending, bilateral or through international institutions, through direct investment by citizens of the former in enterprises in the latter, and through a variety of trading arrangements, chiefly in connexion with the financing of exports to the lower-income countries, but also in respect of pricing and marketing systems. Though it is not always possible to quantify these three types of flows from the regular balance of payments reporting, they give rise to very distinct policy problems and therefore merit separate discussion.[3]

ACCESS TO THE CAPITAL MARKET

Capital markets exist in all countries where lending is carried out on a commercial scale and facilities exist for trading in bonds or stocks, but there are in fact very few capital markets of international significance. They comprise a complex of financial institutions and machinery for lending and for inviting subscriptions to new issues. To have access to such a market implies ability to seek a loan from one or more of the institutions or to float a new issue of bonds or stocks. Even though access does not of itself ensure success in obtaining funds—since the terms on which funds are made available may differ widely from one borrower to another as well as from time to time—the mere fact of potential availability may be a considerable financial advantage in the orderly administration of a country's external accounts.

Access in this sense is often the fruit of traditional institutional links, especially those arising from trade and its financing, and from the geographical spread of a commercial banking system. Thus, the major trading patterns tend to reflect the sort of economic relations which have provided certain of the developing countries with access to particular capital markets. Three such special links are discernible —those of the franc zone countries with Paris, the Commonwealth countries with London, and the Latin American countries with New York.

As a result of the high degree of financial integration that has existed between the developing coun-

[3] Some of the difficulties of interpreting reported data relating to private capital flows are indicated in document E/4171, "The Measurement of the Flow of Resources from the Developed Market Economies to the Developing Countries, Interim Report of a Group of Experts appointed by the Secretary-General"

tries in the franc zone and metropolitan France, the former have continued to have direct access to the financial resources of the French banking system. The fact that their monetary reserves have normally been kept in France has meant that a line of credit has usually been available at the Bank of France or the Treasury, much in the same way as facilities are provided by the International Monetary Fund for its member countries. Similarly, special financial links exist between the developing countries in the Commonwealth and the United Kingdom, both through the operation of United Kingdom banks abroad and through direct transactions on the London market. Before the war, indeed, virtually all the capital moving to less developed Commonwealth countries originated in the United Kingdom. Comparable in many ways are the economic ties that have grown up in Latin American countries with the United States: though new-issue activity has never recovered from the borrower defaults of the nineteen thirties, the banks have continued to provide various types of financial support, longer-term loans as well as short-term accommodation.

From the point of view of the developing countries the other leading capital markets have tended to play a less important role: they are mostly smaller in terms of the resources at their disposal and generally lack the banking contacts which often serve to direct the demand for capital to the international markets. Nevertheless, in one form of financing, namely, the issuing of new bonds, the capital markets of Belgium, the Federal Republic of Germany, Italy, Japan, the Netherlands and Switzerland have all contributed in the post-war period.

In contrast to its importance for the financing of economic development before the First World War, however, the bond market has played a very minor role in recent years. Indeed, the use of the bond market for foreign issues of all kinds has hardly been significant: in the period 1962-1964, for example, foreign issues constituted less than 5 per cent of the net amount—averaging over $28 billion a year—raised in this way in the developed market economies (*see* table A.II-1 in the annex to this chapter). And of the foreign issues themselves, those made on behalf of the developing countries accounted for only about 10 per cent, appreciably less than at the beginning of the nineteen fifties (*see* table II-3).

Relatively few of the developing countries have in fact raised funds on the bond market in the post-war period, and those that have are the countries or territories with the closest institutional ties to the financial centre concerned. Thus, the only borrowers on the London new-issues market have been de-

Table II-3. Gross foreign bond issues: Proportion of amount raised on selected capital markets accounted for by developing countries, 1952-1964

(*Percentage*)

Year	Belgium	United Kingdom	United States	Six major countries[a]
1952	—	81	14	33
1953	—	54	11	25
1954	99	52	11	24
1955	91	47	29	29
1956	100	45	10	20
1957	—	25	7	11
1958	50	24	7	11
1959	—	37	8	9
1960	—	8	25	18
1961	—	—	16	12
1962	—	3	9	7
1963	—	30	8	9
1964	—	11	17	13
Average	71	32	12	14

Source: Banque nationale de Belgique, *Bulletin d'Information et de Documentation* (Brussels): Deutsche Bundesbank, *Monthly Bulletin* (Frankfurt-am-Main); de Nederlandsche Bank, *Report for the Year* (Amsterdam); Banque nationale suisse, *Bulletin mensuel* (Zurich); United Kingdom, *Midland Bank Review* (London); Bank of England, *Quarterly Bulletin* (London); United States Department of Commerce, *New Foreign Securities offered in the United States, 1952-1964* (Washington, D.C.); Federal Reserve System, Board of Governors, *Federal Reserve Bulletin* (Washington D.C.); Wedd, Jefferson and Company, *The Gilt-edged Market* (London) (January 1965); Arthur-Bonnewyn, *Memento des Valeurs* (Brussels, December 1960).

[a] Belgium, Federal Republic of Germany, Netherlands, Switzerland, United Kingdom and United States, which together absorbed more than 90 per cent of bond issues by developing countries in this period.

pendent territories (whose debt is guaranteed by the United Kingdom Government) or newly independent members of the Commonwealth (Ceylon in 1954, the former Federation of Malaya in 1963 and Nigeria in 1963). The only borrowers on the New York market have been western hemisphere countries and territories and countries with special relations (Israel, which has issued bonds each year, and Liberia and the Philippines in 1964). During the period 1952-1964 the only exceptions to this pattern were issues of the former Belgian Congo and the former Federation of Rhodesia and Nyasaland on the New York market in 1958, earlier issues by the Belgian Congo and by Peru on the Geneva market and two unlisted issues of Argentina in Geneva and Frankfurt in 1961 (*see* table II-4). In the aggregate, the bond market has provided the developing countries with an average of less than $150 million a year. The amount has fluctuated erratically from year to year and, although 1964 registered by far the highest total, there has been no systematic tendency to increase.

Apart from the inertia that tends to come of usage, there are various other impediments to access.

Table II-4. Developing countries: Gross value of bond issues in developed market economies,[a] 1952-1964

(*Millions of dollars*)

Region, capital market and borrowing country	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*	*1961*	*1962*	*1963*	*1964*
Latin America, total	1.4	12.1	11.8	9.6	9.9	2.6	30.7	20.9	118.6	72.0	49.5	61.3	109.4
New York, total	—	—	—	8.0	—	—	16.8	12.5	109.1	37.0	45.9	53.9	96.2
Bahamas	—	—	—	—	—	—	—	—	—	—	11.0[b]	—	—
Bermuda	—	—	—	—	—	—	—	—	—	b,c	—	—	—
Colombia	—	—	—	—	—	—	—	—	—	—	—	—	2.5[b]
Cuba	—	—	—	8.0	—	—	—	—	—	—	—	—	—
Jamaica	—	—	—	—	—	—	—	12.5	—	—	—	1.5[b]	—
Mexico[d]	—	—	—	—	—	—	—	—	80.6[b]	17.7[b]	20.0[b]	43.1[b,d]	79.9[b,d]
Netherlands Antilles	—	—	—	—	—	—	—	—	—	b,c	7.0[b]	—	—
Panama	—	—	—	—	—	—	16.8	—	28.5[b]	—	7.9	9.3[b]	—
Trinidad and Tobago	—	—	—	—	—	—	—	—	—	—	—	—	7.5
Venezuela	—	—	—	—	—	—	—	—	—	—	—	—	6.3[b]
London, total	0.9	10.7	11.8	—	9.9	—	13.9	8.4	9.5	—	3.6	7.4	13.2
British Guiana	—	—	—	—	9.9	—	—	—	—	—	—	—	—
Jamaica	—	10.1	—	—	—	—	11.8	—	9.5	—	—	4.2	9.0
Leeward Islands[e]	—	—	—	—	—	—	1.3	—	—	—	—	2.3	—
Trinidad and Tobago	—	—	11.8	—	—	—	—	—	—	—	—	—	—
Windward Islands[f]	0.9	0.6	—	—	—	—	0.8	8.4	—	—	3.6	0.9	4.2
Geneva, total	0.5	1.4	—	1.6	—	2.6	—	—	—	32.0	—	—	—
Argentina	—	—	—	—	—	—	—	—	—	32.0[g]	—	—	—
Peru	0.5	1.4	—	1.6	—	2.6	—	—	—	—	—	—	—
Frankfurt, total	—	—	—	—	—	—	—	—	—	3.0	—	—	—
Argentina	—	—	—	—	—	—	—	—	—	3.0[g]	—	—	—
Africa, total	116.0	88.5	94.5	87.1	77.6	43.4	89.0	28.0	—	—	—	17.8	—
New York, total	—	—	—	—	—	—	21.0	—	—	—	—	—	—
Former Belgian Congo	—	—	—	—	—	—	15.0	—	—	—	—	—	—
Rhodesia and Nyasaland (former Federation of)[h]	—	—	—	—	—	—	6.0	—	—	—	—	—	—
Liberia	—	—	—	—	—	—	—	—	—	—	—	—	b,c
London, total	102.0	74.5	50.5	45.1	21.6	43.4	28.0	28.0	—	—	—	17.8	—
East Africa Common Service Organization	27.7	16.0	19.7	—	9.8	32.2	—	—	—	—	—	—	—
Kenya	17.1	18.2	2.8	—	11.8	—	—	—	—	—	—	—	—
Tanganyika	6.4	12.3	—	—	—	11.2	—	—	—	—	—	—	—
Uganda	16.8	—	—	11.2	—	—	—	—	—	—	—	—	—
Mauritius	—	—	—	5.9	—	—	—	—	—	—	—	5.9	—
Nigeria	—	—	—	—	—	—	—	—	—	—	—	11.9	—
Rhodesia and Nyasaland (former Federation of)[h]	—	—	28.0	—	28.0	—	28.0	28.0	—	—	—	—	—

Table II-4. Developing countries: Gross value of bond issues in developed marked economies,[a] 1952-1964 (*continued*)

Region, capital market and borrowing country	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*	*1961*	*1962*	*1963*	*1964*
Former Northern Rhodesia	7.1	—	—	—	—	—	—	—	—	—	—	—	—
Former Nyasaland	5.9	—	—	—	—	—	—	—	—	—	—	—	—
Southern Rhodesia	21.0	28.0	—	—	—	—	—	—	—	—	—	—	—
Brussels, total	—	—	44.0	42.0	42.0	—	40.0	—	—	—	—	—	—
Former Belgian Congo	—	—	44.0	42.0	42.0	—	40.0	—	—	—	—	—	—
Geneva, total	14.0	14.0	—	—	14.0	—	—	—	—	—	—	—	—
Former Belgian Congo	14.0	14.0	—	—	14.0	—	—	—	—	—	—	—	—
Asia, total	51.6	40.2	59.3	60.1	53.0	51.4	47.0	51.7	50.9	58.2	60.2	80.6	101.8
New York, total	46.8	36.5	40.0	41.9	53.0	51.4	47.0	51.7	50.9	58.2	60.2	66.6	101.8
Israel	46.8	36.5	40.0	41.9	53.0	51.4	47.0	51.7	50.9	58.2	60.2	66.6	93.8
Philippines	—	—	—	—	—	—	—	—	—	—	—	—	8.0[b]
London, total	4.8	3.7	19.3	18.2	—	—	—	—	—	—	—	14.0	—
Aden	—	3.7	—	—	—	—	—	—	—	—	—	—	—
Ceylon	—	—	14.0	—	—	—	—	—	—	—	—	—	—
Cyprus	4.8	—	—	10.1	—	—	—	—	—	—	—	—	—
Malaya (former Federation of)	—	—	5.3	8.1	—	—	—	—	—	—	—	14.0[i]	—
Total, all developing countries	169.0	140.8	165.6	156.8	140.5	97.4	166.7	100.6	169.5	130.2	109.7	159.7	211.2

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United States Department of Commerce, *New Foreign Securities offered in the United States, 1952-1964*; Wedd, Jefferson and Company, *The Gilt-edged Market*; Arthur Bonnewyn, *Memento des Valeurs*; Dresdner Bank (correspondence); Société des Banques suisses, *Manuel des Valeurs cotées à la Bourse de Genève et des Changes, 1965* (Geneva).

[a] Private issues are specified in the case of the New York market, but not in the case of the London, Brussels and Geneva markets, where the amounts involved are believed to be relatively small.

[b] Private placements.

[c] Unspecified amounts of not less than $0.5 million; for Bermuda and the Netherlands Antilles, the combined total is $19.3 million, which is included in the 1961 total for Latin America; in the case of Liberia, the amount is known to be less than $9.3 million; it has not been included in the 1964 total for Africa.

[d] Private placements amounting to $3.1 million in 1963 and $11.9 million in 1964.

[e] Antigua, Dominica and St. Christopher.

[f] St. Lucia, St. Vincent, Barbados and Grenada.

[g] Unlisted.

[h] The Federation was dissolved on 31 December 1963 in accordance with the Federation of Rhodesia and Nyasaland (Dissolution) Order in Council, 1963, approved by Parliament on 17 December 1963. Under section 16 (6), the liabilities of the Federation in respect of each of the following stocks—4 per cent, 1972-1974; 5 per cent, 1975-1980; 6 per cent, 1976-1979; 6 per cent, 1978-1981, issued in 1954, 1955, 1958 and 1959—were transferred to the Governments of the Territories as follows: 52.120 per cent to Southern Rhodesia; 37.127 per cent to Northern Rhodesia, and 10.753 per cent to Nyasaland. Under section 12 (as modified), the Federation stocks disappeared on 1 January 1964, and each holder had his holding divided according to the stated ratios into separate stocks of the three Territories, carrying the same rates of interest, dividend dates and maturity dates as his original stock.

[i] Issued by the Government of Malaysia.

In practically all European countries, for example, foreign issues have been subject to licensing by the ministry of finance or the central bank, and in Denmark and Norway no such authorization has been granted in the post-war years. In France, the first authorization of foreign issues other than those of the overseas franc area was made only in 1963, while in recent years in Switzerland and the Netherlands the monetary authorities have restricted foreign issues in order to relieve the strain on the domestic capital market.

Cost is also an obstacle. In many countries there are taxes on new issues, and in all cases there are underwriting and administrative charges. For a small issue and for a borrower of less than perfect credit standing, the bond market often turns out to be a very expensive source of capital. The initial cost of public borrowing depends on many factors, including, in particular, the size of the issue, the standing of the borrower, the manner in which the bonds are placed and the state of the market at the time, and consequently there tend to be significant differences from one market to another. On the whole, the larger and better organized markets in New York and London tend to offer the lowest range of costs (*see* table II-5).

Table II-5. Initial costs[a] of public bond issues in selected capital markets, 1963

(Percentage of value of issues)

Country	Domestic issues		Foreign issues	
	Initial tax	*Approximate total cost*	*Initial tax*	*Approximate total cost*
Belgium	0.7	3.5–5.0	1.6	
France	—	6.0[b]	—	...
Germany (Federal Republic)	2.5[c]	7.0–8.0	2.5[c]	7.0–8.0
Italy	0.6[d]	5.5–8.5	1.4–2.4	.
Netherlands	0.7[c]	2.5	2.0	4.0–5.0
Switzerland	0.6[c,e]	3.0–3.5[c]	1.2[c,e]	3.5–5.0
United Kingdom	0.1[c,f]	3.0	2.0[g]	4.2–4.5
United States	0.2[c,h]	1.0–2.0	—[h]	1.2–4.7

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on Bank of England, *Quarterly Bulletin*, June 1963

[a] Including taxes imposed on the borrower, underwriting charges and various fees payable to the issuing house and to banks and brokers and stock exchanges, and advertising expenses

[b] Including turnover tax.

[c] In terms of par value.

[d] Including 0.5 per cent annual tax on bonds normally paid by borrowers and not reclaimed from subscribers.

[e] In addition, a tax of 3 per cent on interest and dividend payments is payable annually by Swiss companies For non-resident borrowers, the tax is payable in advance at 2 per cent of total interest payments.

[f] In registered form.

[g] In bearer form.

[h] Ignoring a small fee payable to the Securities and Exchange Commission when documents are filed

In the aggregate over the post-war period, developing countries have drawn funds from the capital markets of the developed market economies to the extent of about $2.5 billion—a miniscule proportion both of the amount of borrowing effected on those markets and of the total inflow of capital into the developing countries. It is significant that during this same period the International Bank for Reconstruction and Development (IBRD) was, on its own, able to raise a comparable sum by means of public issues on the same markets[4] (*see* table II-6). This was achieved by dint of a careful building up of public confidence in the operations of the Bank. In this, it started with the advantage of a constitution which designated 80 per cent of members' subscriptions as a guarantee fund available on call if required to meet the Bank's obligation. The process was facilitated by governments' willingness to make legislative provisions enabling various financial institutions to hold Bank obligations. This helped the Bank to tap some of the capital markets to which individual developing countries have not had access and to place about half its own bond issues privately rather than by public offer. The Bank has also been able to sell a sizable proportion of its loan portfolio to private investors, thus in effect acting as an underwriter in the raising of capital.

Following in the footsteps of the IBRD has been the Inter-American Development Bank (IDB) which has also succeeded in floating loans in a number of European countries as well as in the United States. Significantly, an increase of its resources

[4] Altogether, up to the end of 1965, the IBRD—which has a paid-up capital of $2billion—had sold or placed eighty-five issues of its own securities (totalling over $4.8 billion, of which about $2.7 billion was outstanding) as well as about $2 billion of its loan portfolio.

Table II-6. International Bank for Reconstruction and Development: Funds drawn from the capital market, 1947-1965

(Millions of dollars)

Item	*1947-1951*	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*Total, 1947-1965*
Public issues, total	525.6	135.5	98.2	159.2	36.0	—	275.0	410.0	101.2	153.5	61.3	139.3	—	—	300.1	2,394.9[a]
United States	500.0[b]	110.0	75.0	100.0	—	—	275.0[c]	400.0[c]	—[c]	125.0[c]	—	100.0[c]	—	—	200.0	1,885.0
Switzerland	11.6	11.6	23.2	11.6	11.6	—	—	—	23.2	28.5	23.3	23.3	—	—	14.5	182.4
Germany (Federal Republic)	—	—	—	—	—	—	—	—	50.0	—	—	—	—	—	62.5	112.5
Canada	—	13.9	—	23.1	13.9	—	—	—	—	—	—	—	—	—	23.1	74.0
Netherlands	—	—	—	10.5	10.5	—	—	—	—	—	14.0	11.0	—	—	—	46.0
United Kingdom	14.0	—	—	14.0	—	—	—	—	28.0	—	—	—	—	—	—	56.0
Italy	—	—	—	—	—	—	—	—	—	—	24.0	—	—	—	—	24.0
Belgium	—	—	—	—	—	—	—	10.0	—	—	—	—	—	—	—	10.0
Austria	—	—	—	—	—	—	—	—	—	—	—	5.0	—	—	—	5.0
Other issues[d]	10.6	—	—	50.0	—	75.0	221.5	265.0	273.0	400.0	489.0	105.0	100.0	200.0	234.8	2,423.9
Sales of loans and portfolio	33.4	32.3	18.4	56.5	155.9[e]		74.9	98.3	181.7	242.7	203.8	307.0	322.5	116.2	96.5	1,940.1
Total funds from capital market (gross)	569.6	167.8	116.6	265.7	266.9[e]		571.4	773.3	555.9	796.2	754.1	551.3	422.5	316.2	631.4	6,758.9

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on International Bank for Reconstruction and International Development Association, *Annual Report*, various issues (Washington, D.C.), and International Monetary Fund, *International Financial Statistics* (Washington, D.C.).

[a] Of which, $1,885.0 million was still outstanding on 30 June 1965, excluding $17.9 million deferred delivery in 1965.

[b] $100 million of the amount issued on the New York market went to refinance the 1947 $100 million ten-year issue.

[c] Beginning in 1957, creditors were offered the option of buying bonds with payment and delivery deferred for a period ranging up to two years and nine months. A certain portion of several issues was sold on these terms on the United States market: 1957, $68.3 million; 1958, $28.8 million; 1960 $27.6 million; 1962, $5.5 million, and 1965, $17.9 million.

[d] Short-term and medium-term private placements.

[e] Sales of loans for these two years cannot be separated.

effected in 1963 was primarily in the form of an extra one billion dollars in callable capital as backing for borrowing on the market.

The example of the multilateral banks and the predominance among individual borrowers of countries with guarantees or special relations to the lending market suggest that the key providing access to the capital market is confidence, or what the potential lenders regard as credit-worthiness. To the extent that this is so, it constitutes a formidable obstacle to the conventional bilateral use of capital markets by the developing countries, for the latter's need for external capital is seldom likely to be measurable by the sort of commercial criteria which are applied in a market of professional lenders, private and institutional. Indeed, the urgency of need for development purposes may often vary inversely with normal standards of credit-worthiness, for public borrowing across international boundaries involves an assessment not only of the viability of the project to be financed or the taxable capacity of the authority in question but also of the latter's ability to carry the service burden in terms of a convertible currency.

Quite apart from access and initial flotation cost, but closely related to them, is the matter of maturity and interest cost. The terms on which individual countries are able to borrow vary considerably not only with the state of the market but also with their credit standing. A country whose immediate commercial or economic prospects are judged to be less than assured may have to offer its bonds at an appreciable discount, raising the effective burden of interest above the nominal market rate. There has consequently been a marked contrast between the interest rates payable by individual countries and those payable by the IBRD for loans raised on the same market (*see* table II-7). And, by the same token, developing countries have been able to borrow at much lower rates from the Bank than from the capital market.

The rapid rise in the total debt of the developing countries has made the question of borrowing terms one of increasing importance and urgency.[5] Even lending on IBRD terms has become steadily more problematical: the balance of payments prospects of many developing countries are not sufficiently bright to warrant the imposition of the debt service charges that the regular interest and amortization rates of Bank loans entail. One response to this situation was the creation of the International Development Association (IDA), a "soft-loan" affiliate of the IBRD, able to lend funds provided by member governments and by the Bank itself—for long periods and at nominal rates of interest. Another response was the suggestion by Governor Horowitz of the Bank of Israel to the first United Nations Conference on Trade and Development (UNCTAD)[6]—that the IDA type of lending be expanded by means of a mechanism that would enable funds to be drawn from the capital market. The objective would be to meet simultaneously the difficulties that developing countries face in trying to borrow directly from the market and the difficulties that governments in the developed market economies may face in making adequate predetermined budgetary allocations to the capital of any soft-loan agency. The central mechanism proposed by Governor Horowitz was an "interest equalization fund".[7]

The idea of subsidizing interest rates in now fairly widely accepted. Within countries it has long been practised for particular social purposes, most notably for certain types of housing and, perhaps more significantly in the present context, for attracting investment to depressed areas. Between countries, it lies at the root of aid schemes that are based on grants of capital, and the IBRD has itself practised it, not only in connexion with contributions made to the IDA from its net earnings but also by virtue of the fact that its own loans are rated, in varying degree, below what developing countries would have to pay were they to borrow on the market. And in 1965 the Bank actually introduced an overt two-tier interest system, charging full market rates on loans to the more advanced countries and somewhat lower rates to the developing countries—a differential which, in general, is in inverse relation to their respective credit standings.

The essential difference between the IDA approach as hitherto conceived and the proposed interest equalization fund approach lies less in their interest rate policies than in the difference in the source of funds. The IDA is fed primarily from budgetary

[5] The growth of the external debt of the developing country is discussed in chapter III, below.

[6] *See* United Nations, *Proceedings of the United Nations Conference on Trade and Development, Volume I. Final Act and Report* (Sales No.: 64.II.B.11), annex A.IV.11; also document E/CONF.46/C.3/2.

[7] In its recommendation A.IV.11, UNCTAD requested the IBRD to study the matter. In February 1965, the Bank submitted a staff report entitled *The Horowitz Proposal*, paying particular attention to the difficulties that the scheme might encounter. This report was referred by UNCTAD to an expert group for further consideration. The group reported in April 1966 in favour of experimenting on a limited basis with a modified scheme in which the IBRD would be the borrowing agency (at least in the first instance) and the IDA (its charter appropriately modified), the lending agency. A reserve fund for making good the required interest differential would be set up in the latter. Great stress was laid on the importance of preserving the high credit standing of the Bank. It was argued that the feasibility of the scheme would depend very largely on the nature of the guarantees that the governments of the participating developed market economies were prepared to give. But some members of the group felt that if limits were placed on the size of the operation, a separate set of guarantees would not be necessary.

Table II-7. Interest rates payable on new bond issues, 1954, 1958 and 1963

Year and market	*Borrower*	*Size of issue (millions of dollars)*	*Maturity (years)*	*Rate of interest (percentage per annum)*	*Issue price (dollars per $100)*	*Yield[a] (percentage)*
1954						
London	Trinidad	12	22	4.00	99.50	4.03
	EACSO	6	20	4.00	97.75	4.17
	EACSO	14	22	4.00	100.00	4.00
	Kenya	3	22	4.50	97.50	4.68
	Ceylon	14	21	4.00	97.00	4.68
	Malaya (former Federation of)	5	22	3.00	100.00	3.00
	Rhodesia and Nyasaland (former Federation of)	27	20	4.00	97.50	4.18
	IBRD	14	20	3.50	98.00	3.64
New York	Israel	40		3.5 to 4	100.00	3.5 to 4
	IBRD	100	15	3.50	100.00	3.50
Brussels	Former Belgian Congo	44	20	4.25	97.60	4.43
1958						
London	Jamaica	12	24	6.00	96.50	6.28
	Leeward Islands	1	22	6.00	97.00	6.25
	Windward Islands	1	20	6.00	96.00	6.36
	Rhodesia and Nyasaland (former Federation of)	27	21	6.00	96.00	6.36
New York	Panama	17	35	4.80	101.50	4.71
	Former Belgian Congo	15	15	5.25	98.50	5.40
	Rhodesia and Nyasaland (former Federation of)	6	20	5.75	97.50	5.97
	Israel	47		4.00	100.00	4.00
	IBRD	150	21	4.25	99.50	4.29
	IBRD	150	10	3.75	100.00	3.75
	IBRD	100	15	4.50	100.00	4.50
Brussels	Former Belgian Congo	42	6	5.50	97.20	6.10
1963						
London	Jamaica	4	12	6.75	96.00	7.25
	Leeward Islands	2	12	6.50	95.00	7.13
	Windward Islands	1	12	6.50	95.00	7.13
	Mauritius	6	12	6.50	96.50	6.94
	Nigeria	12	20	6.00	99.50	6.04
	Malaysia	14	10	6.50	98.00	6.78
New York	Jamaica	2		7.00	100.00	7.00
	Mexico	3		7.50	100.00	7.50
	Mexico	15		6.00	100.00	6.00
	Mexico	25		6.75	97.70	7.00
	Panama	9	48	4.50		
	Israel	67		4.50	100.00	4.50

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United States Department of Commerce, *New Foreign Securities offered in the United States, 1952-1964*; Wedd, Jefferson and Company, *The Gilt-edged Market*: Arthur Bonnewyn, *Memento des Valeurs*; Dresdner Bank (correpondence); Société des Banques suisses, *Manuel des Valeurs cotées à la Bourse de Genève et des Changes, 1965*.

[a] Interest expressed as a percentage of issue price.

allocations by participating governments; an interest equalization fund would be used to fill the gap between the borrowing rate and the lending rate of an institution which drew its funds from the capital market. A budgetary allocation for such a fund would thus, in principle, facilitate the lending of amounts many times larger: if the allocation were assured for a number of years ahead—by a subscription arrangement, for example—a high gearing might be achieved between the annual interest subsidy and the capital transfer.

The misgivings that have been expressed about a subsidy fund of this nature reflect doubt concerning the willingness of governments to provide the guarantees without which the borrowing agency could not approach the market as well as fear of the impact of such borrowing on the regular operation of the IBRD and, in present circumstances, on the market itself. Concern about the reaction of lenders stems partly from longer-term history of the international capital market and partly from the severe stringency that has characterized the most recent period. As suggested at the beginning of this discussion, few of the national capital markets have recovered from the traumatic effects of the First World War and its economic aftermath and the Great Depression. It is only in recent years, with the tremendous expansion in the New York market and the restoration of convertibility of most western European currencies, that international use of individual capital markets has begun to assume significant dimensions. In the past ten years about one-sixth of the foreign issues floated on the New York and London markets have actually been purchased by non-residents, and more recently some of the continental European markets have absorbed new foreign issues denominated in European Economic Community (EEC) units of account. But the process of reconstituting an international capital market playing a development role comparable to that of an earlier age has not gone very far. In the most recent period, moreover, it has been slowed down by the external payments disequilibrium of the two major exporters of capital which has impelled these countries to restrain the outflow of funds.[8] While efforts have been made to mitigate the impact of this on the developing countries, the measures that have been adopted have inevitably impeded the operations of banks and other lending institutions and hence adversely affected the functioning of what is still a very sensitive piece of economic machinery.

Given the weak position of most of the developing countries, there would seem to be no early prospect of their being able to draw larger sums from the capital market on the basis of their own credit. If resources are to be put at their disposal from private lenders, it will have to be through an agency that is adequately underwritten by the governments of the developed market economies. This would be so even if the transfers were carried out on more or less commercial terms; for sub-economic loans official support would be indispensable. While this could be effected at the national level by merely increasing the scale of current bilateral operations of this nature, there would be some advantage in organizing it on an international basis. For, in principle, an interest equalization fund would be easy to adapt to the sort of imbalance which currently exists: deficit countries could contribute to the interest subsidy while surplus countries provided the actual capital. The essential requirement would be an institution which inspired general confidence and whose obligations could be legally held as assets by the various financial entities through which the supply of capital moves on to the market.

The present market stringency brings home another crucial point. What is involved is a transfer of real resources, and the decision to forgo the use of capital in the domestic economy in order to make it available to a developing country is not necessarily or entirely an economic one. The discussion stimulated by the Horowitz proposal and by the need to replenish the funds at the disposal of the IDA is concerned in essence with the evolution of mechanisms for effecting the desired transfer on an international basis that is most equitable from the point of view of burden sharing and least disruptive from the point of view of capital market operation and external payments.

Direct investment

In many ways, direct investment is potentially the most development-inducing form in which external capital can be provided. It is usually embodied in a package containing all the strategic complementary factors necessary to create a viable economic production unit in the country of destination. In the long run its success is bound up with the progress of the host country, so that in principle there should be a convergence if not an identity of interests between the country and the foreign investor. In varying degree, there is likely to be a useful developmental spill-over into the rest of the economy, not only from the taxes the enterprise may be subject to, but also from its purchases of local goods and services, its stimulus to ancillary activities, its training and demonstration effect, its contribution to the so-called "external economies" of the area in which it is sited, and sometimes by its provision of infra-

[8] *See* United Nations, *International Flow of Long-term Capital and Official Donations, 1961-1965* (Sales No.: 66.II.D.3).

structure in which other enterprises can share. In most cases the investment does not add to the country's fixed interest-bearing external debt; only if the enterprise is profitable are the foreign factors likely to receive an income and hence constitute a claim on convertible currency. And if established in the export sector, the foreign enterprise may be a large net contributor of foreign exchange to the economy on a continuing basis.

In favourable circumstances the investment may be to the advantage of the capital exporting country also: it may reflect a geographic division of labour from the success of which the source country may be expected to benefit, at least in the fulness of time, when profits are realized and remitted.

In the real world, however, circumstances are rarely at their potentially most favourable, and from time to time during the post-war period the emphasis of events and policies has been on manifestations of divergence, or even conflict of interest. At the root of the problem in many instances has been the adoption of different time horizons by the various parties. As suggested above, interests may converge only in the long run and when action is based on short-run considerations—whether by the company in respect of its investment, production or marketing policies or by the host government in respect of its fiscal or commercial policies—the result may often be not only conflict of immediate interests but also some prejudice to the longer-run course of capital inflow, national output or tax revenue.

In this respect, many of the difficulties that have been encountered in recent years are inherent in the situation and therefore, unless specifically dealt with, are likely to persist. They affect all three parties to the operation—the host country, the foreign-owned enterprise and the country from which the capital originated. In most cases, however, the problems arising in the host country—reflecting the interaction of the policies and practices of government and company—have probably done more to determine the course of direct investment than have the measures enacted in the capital exporting countries.

One of the most frequent difficulties has its genesis in the belief that the company is not always an autonomous entity seeking to maximize its own net revenue but rather an accessory to some parent body which determines production and pricing policies in the interest of the organization as a whole and in the light of tax and other economic conditions in all the countries in which it many operate. In intra-company transactions in these circumstances the profit of any one subsidiary may be sacrificed in the interest of a unit more favourably situated from the point of view of the whole concern. If the output of the company is sold on the world market, there is thus a strong pressure on a particular host country to treat the foreign company at least as favourably as does any other country in which it may operate.

As most direct foreign investment is in fact effected not by individual owners of capital but through the establishment of branches or subsidiaries by operating concerns, this problem of autonomy underlies many conflicts of interest. To resolve these requires understanding and goodwill on both sides in an area in which it is extremely difficult to codify sound practice in any detail. This is especially true where the foreign concern is a large one in relation to the size of indigenous enterprises, and perhaps even in relation to the host government itself. In general, the larger the concern the greater is its responsibility for ensuring that its policies and actions are not inimical to the rest of the local economy.

The host government with its development needs pressing hard upon it and its political position not always stable or assured, may often find itself under great pressure to take a rather short view of its relations with a foreign enterprise, exacting from it as large as possible a contribution to its own resources by way of taxes on profit or on foreign exchange earnings. Similarly, in an attempt to maximize the immediate developmental impact of the enterprise, it may lay down rules about local staffing and management which are awkward to implement because of the wide disparity that inevitably exists in skill and wage levels between the area of operation and the country of origin of the capital. The disparity between expatriates and local recruits needs to be handled with the utmost caution if it is to be prevented from either lowering the efficiency of the firm or saddling the host country with an inappropriate wage structure.

Many of the factors influencing the volume of direct foreign investment are by-products of difficulties experienced by the governments of developing countries in dealing with private enterprise as such within the framework of a development plan. A good deal of experimentation is likely to be necessary before individual developing countries work out ways and means of integrating the private sector into a development plan which may consist in essence of an articulated series of investments in the public sector plus a system of incentives and deterrents to harness the private sector as effectively as possible to the same or appropriately related objectives. If the conditions are too unfavourable, foreign investment will not be forthcoming. Where it is undertaken, it is incumbent on the foreign enterprise to abide by the general rules and work towards the same general objectives.

The government's purposes are likely to be best served if it succeeds in winning full co-operation from the private sector, including the foreign-owned segment. The task calls for a nice balance in official policies: if the government is too lax, actions taken by foreign firms may run counter to its immediate stability or growth aims; policies that are too restrictive, on the other hand, may induce such firms to seek to maximize short-run profits, to recover capital in the shortest possible time and to repatriate as much of it as is allowed, usually to the detriment of their long-run developmental potential. Thus, even well-intentioned efforts on the part of a host government to influence the price and production policies of foreign-owned concerns have sometimes been self-defeating.

There is no assured way of avoiding all clashes of interest, but post-war experience suggests that regular consultation between government and management may help to make regulations more realistic, more acceptable and more readily enforceable. The proportion and grade of local labour employed, the proportion of local materials or components embodied in the product, the rate of growth of output, the rate of remitted profit are among the matters about which the host government is understandably concerned, and hence likely to want to influence. Recent experience has shown that when the measures are judiciously chosen and realistically applied, such influence can be effectively brought to bear on foreign-owned enterprises, persuading them that their ties to the local economy should not be less close than their ties to parent or sister companies in other countries.[9]

Recent history also has many examples of conflicts of interest that have not been resolved by a mutual recognition of rights. The emergence or resurgence of nationalist sentiments in many of the developing countries in the post-war period and the failure of many foreign enterprises to identify their long-run interests with those of the host country have been among the major deterrents to direct investment. The former has sometimes resulted in the closing of certain industries—petroleum, as in Argentina and Brazil, for example, and communications and steel in India—to the foreign investor. The latter has resulted in a marked reluctance to expand production or investment on the part of foreign-owned companies—such as, on various occasions during the past decade, those mining petroleum in Iraq, bauxite in British Guiana and copper in Chile.

A further deterrent to direct investment has arisen from time to time from the other end of the flow—when one of the capital exporting countries has also felt impelled to take the short view and restrain the outflow in the interest of immediate balance of payments relief. Italy and Japan have imposed such restraints in the past, and more recently the United Kingdom and the United States. Though in the case of the United States, the outflow of capital to developing countries—with the exception of the major petroleum exporters—has been specifically exempted from the system of voluntary control, the 1965 request to corporations to make a 15-20 per cent improvement in their contribution to the balance of payments seems likely to affect the size and method of financing direct investment in developing countries, too.

Aside from these aberrations, longer-term considerations have usually prevailed in the more advanced countries and their general policy towards direct investment in the developing countries has been positive. In some cases governments have set up machinery to bring to the notice of local firms the existence of investment opportunities in developing countries. In a few instances, notwithstanding the normal reluctance of the treasury to create possible tax loopholes and a general hardening of attitudes towards foreign income in recent years, special fiscal incentives have been granted to investors in developing countries. Thus, the Western Hemisphere Trade Corporations Act of the United States reaffirmed a 14-percentage point reduction in tax rates for corporations doing 95 per cent of their business in the Western Hemisphere, while in the Federal Republic of Germany, the Development Assistance Tax Law, enacted in 1963, offered several concessions to investors in the developing countries, including an immediate depreciation allowance of 15 per cent of the investment and provisions for tax deferment. More generally, the fiscal systems in Canada, the Netherlands and Switzerland, exempt foreign income from

[9] Illustrative of the sort of problems that have to be faced is the evolution of assembly plants on which a good deal of the industrialization of the developing countries has been based. It has been common practice for developing countries to seek to accelerate the historical process by setting progressively higher targets for the proportion of locally produced components in the final product (often accompanied by a penalty, by way of taxation or import restraint, for non-attainment). The incorporation of local components has important implications for the design of the product. Because of the relatively small size of the local market, it often becomes uneconomic and sometimes technically difficult to incorporate in the local product design changes effected in the parent company: simpler components and longer production runs are usually essential for efficient manufacture in the developing country. In the case of some products—most notably motor-cars and other consumer durables but also other engineering items—after a few years, the erstwhile assembly plant may be producing an article differing significantly from that produced by its parent concern. This process affects both the economies of scale of the various units of the foreign enterprise and the inflow of technological advances into the host country. Hence, if measures to stimulate development in this way are to be of long-run benefit to the developing country, they obviously have to be introduced cautiously and in consultation with all the parties involved.

domestic tax, thus providing a tax advantage to an investor who owns shares in an enterprise in a developing country with a lower corporate tax rate.

The capital exporting countries have also taken steps to overcome the obstacles to new investment arising from the political and administrative risks and uncertainties implicit in the sort of conflicts of interest referred to above. One approach has been by way of bilateral agreements in which the country of origin and the country of destination agree to a mutually acceptable and reciprocally applicable code of behaviour in respect to direct investment Their general scope is summed up in the common title—for the promotion and protection of capital investments. Difficulties in regard to specific obligations and the precise form of language in which they are couched have not prevented a large number of such agreements from being signed. The United States alone has arrangements with over seventy countries, and the Federal Republic of Germany, Japan, Switzerland and the United Kingdom also have entered into pacts with many developing countries. Some of these agreements cover only a single aspect—such as expropriation and compensation or convertibility and the remittance of profits—but others are fairly comprehensive statements of rights and obligations.

Partly on the basis of agreements of this nature, some of the capital exporting countries have instituted insurance or guarantee schemes for use by private investors desirous of covering themselves against various non-commercial and semi-commercial risks of operating in a foreign country. One of the largest of the schemes is that run by the United States: linked initially to the European Recovery Programme (ERP), its coverage was extended in 1951 to other countries that had signed aid agreements, and in 1959 was limited to developing countries participating in an investment guarantee programme operated by the United States Agency for International Development. By the middle of 1965 there were seventy-two such countries and the volume of outstanding guarantees was well over $2 billion, of which more than two-thirds had been granted in respect of investment in developing countries since 1960 (*see* table II-8).[10] Premiums charged for the insurance were reduced in 1965, and in that year over 600 guarantees were issued covering almost $1 billion of investment in developing countries. Similar, though smaller, insurance schemes have been set up in the Federal Republic of Germany—initiated in 1955, and extended in 1959 to cover political risks in developing countries—and, also, on a more limited scale, in Japan.[11]

The United States has also sought to facilitate private investment in developing countries by a scheme under which studies and surveys can be made at the request of a potential investor. The latter bears the full cost if an investment eventuates but only half the cost if it does not. About 200 such surveys have been undertaken under the scheme, and about 10 per cent of them have resulted in decisions to invest.

FINANCING THROUGH TRADE

Resources are transferred to the developing countries through the normal nexus of trade in two principal ways. First, and most commonly, goods may be supplied to them without requiring immediate payment. And, secondly, they may be paid more for the goods that are acquired from them than they would have received had the goods been sold on the open market. The first transfer is a form of loan generally known as "export credit" and the second a form of grant or subsidy usually associated with some bilateral "commodity arrangement". Historically viewed, export credit belongs to one of the oldest forms of financing, associated with the sale of goods ever since the invention of money. In the post-war period, however, the "aid-or-trade" debate on methods of financing economic development has concentrated very largely on how developing countries can best use their export potential for acquiring the wherewithal for domestic investment.

Discussions regarding ways and means of making international trade more productive for the developing countries have always come up against the impasse created by the composition of their exports, consisting overwhelmingly as these do of primary commodities, demand for which responds relatively little to expansion in income in the countries constituting their main markets. Three types of escape from this impasse have been debated—the removal of barriers to trade in the traditional items, the organization of the trade in a particular product in a way that would regulate the flow on to the market and thus raise realized prices, and the devotion of greater effort to increasing trade in goods other than the traditional primary products.

None of these solutions has had more than partial success. The barriers to the primary commodity trade of most of the developing countries are not great—most raw materials and tropical food-stuffs enter

[10] It should be noted that the cumulative sum of the guarantees exceeds the amount of investment covered by a multiple reflecting the number of risks against which insurance has been taken out.

[11] Efforts to multilateralize existing systems of guarantees and to set up international means of settling disputes that may arise between foreign-owned companies and host governments are described in chapter V, below.

Table II-8. United States of America: Investment guarantees[a] and net new direct foreign investment[b] in developing countries, by region, 1960-1964

(Millions of dollars)

Year and item	*Latin America*	*Africa*[c]	*Asia*[d]	*All developing countries*
1960				
Investment guarantees, total	14.0	0.8	3.8	18.6
Convertibility	3.6	0.4	1.6	5.6
Expropriation	10.4	0.4	2.2	13.0
Net new direct investment	95	81	—36[e]	140
1961				
Investment guarantees, total	7.0	13.0	41.4	61.4
Convertibility	1.0	0.8	23.7	25.5
Expropriation	6.0	12.2	17.7	35.9
Net new direct investment	173	125	102	400
1962				
Investment guarantees, total	129.8	81.4	59.4	270.6
Convertibility	121.3	5.5	23.9	150.7
Expropriation	8.5	21.9	21.0	51.4
War risk	—	54.0	14.5	68.5
Net new direct investment	—32[f]	139	26	133
1963				
Investment guarantees, total	69.9	19.3	119.9	209.1
Convertibility	66.5	3.2	32.0	101.7
Expropriation	2.2	12.3	87.3	101.8
War risk	1.2	3.8	0.6	5.6
Net new direct investment	69	97	145	311
1964				
Investment guarantees, total	339.2	2.8	193.2	535.2
Convertibility	112.7	0.4	76.5	189.6
Expropriation	175.1	0.4	80.5	256.0
War risk	51.4	2.0	36.2	89.6
Net new direct investment	156	118	115	389

Source: United States Agency for International Development, *Operation Report*, various issues (Washington, D.C.); United States Department of Commerce, *Survey of Current Business*, August 1961, August 1963 and September 1965 (Washington, D.C.)

[a] The value of new investment guarantees has been calculated from the increment in outstanding guarantees in the twelve months ending 30 June of year stated. As a single investment may be insured against more than one of the three types of risk—expropriation, inconvertibility and war—and there is no means of allowing for double counting, the figures overstate the amount of investment guaranteed.

[b] Data exclude reinvested earnings and refer to calendar years.

[c] Excluding South Africa.

[d] Excluding Japan and Turkey.

[e] A net outflow of $36 million to the Far East was more than offset by a reverse flow of $72 million from the Middle East.

[f] A net outflow of $198 million was more than offset by a reverse flow of $230 million from Bolivia, Costa Rica, Guatemala, Panama and Venezuela.

the developed market economies free of duty—but where they do exist they tend to be firmly entrenched as part and parcel of domestic agricultural policy. Attempts to organize markets on a global scale have been limited to a handful of commodities—tin, sugar, wheat and, more recently, coffee—and have all proved difficult to maintain, soon coming up against two major stumbling blocks, namely, the twin problems of controlling production and financing stocks. And fostering trade in manufactured goods has also run into difficulties: the availability of such goods for export from the developing countries cannot be taken for granted, when available they may often be uncompetitive, and there has been considerable reluctance to introduce preferential tariffs to stimulate such trade.[12]

This is not to say that in specific cases and in a limited fashion, trading arrangements have not been instrumental in financing development. Agreement by a more advanced country to buy a certain item from a particular developing country has often given rise to investment and increased production, and in many cases the importing country has financed

[12] These problems were discussed in some detail in *World Economic Survey, 1963, Part I* (Sales No.: 64.II.C.1).

the expansion. This was practised quite widely by the United States when various mineral supplies were short at the beginning of the nineteen fifties; it has also been practised by the Soviet Union through arrangements to accept service payments on its loans to particular developing countries in the form of the output of the factories it has helped to finance.[13]

On a limited basis, commodity arrangements have also served to increase the export earnings of particular countries. The Commonwealth Sugar Agreement, for example, though essentially a stabilizing device, has raised the sugar receipts of participating countries above what they would have been had their exports all been sold at world market price. Participation in the controlled domestic sugar market in the United States has similarly benefited the developing countries that have been granted quotas for their exports. In much the same way, a number of developing countries have shared in the controlled market for various primary commodities in France. Given the characteristic instability of world market prices, the benefits flowing from such arrangements have varied from year to year; on balance, however, the exporting country has been able to earn appreciably more than it would have done had its output all been sold on the open market (*see* table II-9).

[13] *See* chapter IV, below.

While the earnings from trade are inseparably bound up with the problem of development finance, and in many cases the critical determinant of development financing is the availability of foreign exchange, the improvement of trading results is by no means identical to the provision of capital. Export receipts represent the earnings of the various factors of production engaged in growing, mining, manufacturing and transporting the goods in question. There is a real cost involved, measured by output that might have been produced for domestic use had those factors not been engaged in the export sector. And the export proceeds are distributed among the factors employed, most ending up in the consumption expenditure of workers and some perhaps lost to the economy as the profit of a foreign-owned company operating in the export sector. The proportion available for investment may be very small indeed.

When foreign savings are put at the disposal of the economy, by contrast, they constitute—in their entirety—a net addition to the available resources. In the case of trade, such a result is attainable only if there is a rise in export prices, exogenously determined. Such a windfall improvement in the terms of trade, however, is still subject to the regular process of income distribution among the factors

Table II-9. Receipts of selected developing countries from exports to specific protected markets

Year	*Sugar (raw)*							*Ground-nuts (shelled)*			
	World market price[a] *(dollars per ton)*	*Exports from Mauritius to United Kingdom*[b] *Volume (thousands of tons)*	*Value f.o.b. (millions of dollars) Actual*	*At world market price*	*Imports of United States from Dominican Republic*[b] *Volume (thousands of tons)*	*Value f.o.b. (millions of dollars) Actual*	*At world market price*	*World market price*[c] *(dollars per ton)*	*Imports of France from Senegal*[d] *Volume (thousands of tons)*	*Value c.i.f. (millions of dollars) Actual*	*At world market price*
1956	76.5	430	45.9	32.9	45	5.0	3.5	216	179	49.8	38.7
1957	113.8	419	46.8	47.7	63	7.8	7.2	207	235	54.2	48.7
1958	77.2	425	47.9	32.8	68	8.2	5.2	168	274	55.4	45.8
1959	65.7	396	46.8	26.0	118	14.1	7.7	185	352	71.9	65.2
1960	68.3	268	32.5	18.3	386	43.1	26.4	201	222	46.9	44.7
1961	64.2	392	47.9	25.2	333	35.1	21.3	174	235	51.0	40.8
1962	65.7	440	51.2	28.9	788	95.9	51.8	174	282	60.3	49.1
1963	187.4	454[e]	57.5[e]	85.0	522	80.4	97.8	175	194	42.1	33.9
1964	129.9	430[e]	54.4[e]	55.9	362	52.4	47.0	189	184	39.8	34.8
Total, 1956-1964			431	353		342	268			471	402

Source: Statistical Office of the United Nations, *Monthly Bulletin of Statistics*; France, Ministère des Finances et des Affaires économiques, *Statistiques du Commerce extérieur de la France* (Paris); Mauritius, *Annual Report of Customs and Excise Department*, for the years 1960 to 1962 (Port Louis); Senegal, *Bulletin statistique bimestriel* (Dakar); United States Department of Commerce, *Inputs of Merchandise for Consumption* (FT 110 and FT 112) (Washington, D.C.); International Sugar Council, *Statiscal Bulletin* (London), December 1965; F. O. Licht, *International Suger Report* (Ratzeburg), September 1963.

[a] Spot raw centrifugal 96° in bulk, f.o.b. Caribbean.

[b] Including a certain (usually small) amount of raw sugar of higher polarization.

[c] Nigerian, shelled, nearest futures, c.i.f. European ports.

[d] For 1956-1958, exports from Senegal to France valued at average unit value of imports into France from franc zone; for 1959, imports into France from French West Africa.

[e] United Kingdom imports from Mauritius valued at the negotiated price under the Commonwealth Agreement.

involved—unless indeed, as indicated in chapter I above, it is intercepted by the government through an appropriately designed tax. In the case of an external loan or donation, whether to the public or to the private sector, the resources made available may all be committed to investment: the development potential is much greater than that of an equivalent increment in exports. However desirable an expansion in trade, it cannot be regarded as a substitute for its equivalent in "aid". This conclusion was particularly pertinent during the second half of the nineteen fifties, when the rise in the export earnings of the developing countries was accompanied by a deterioration in the terms of trade. The resultant windfall losses offset—fairly generally but to an extent that varied widely from country to country—the net inflow of new capital by way of external loans and grants.

Though export volumes have continued to expand and export prices have tended to stabilize—at least on the average—in recent years, the course of events over the whole post-war period suggests that trade is hardly a substitute for capital transfers as a means of financing development. The developing countries as a whole have been in virtually unbroken deficit on trade account ever since the early nineteen fifties, and even though the bulk of their foreign exchange supplies will doubtless have to continue to come from export sales, their dependence on foreign capital is likely to increase rather than diminish if rates of economic growth are to be stepped up.

In these circumstances, the interest of developing countries in being able to obtain imports on credit is understandable. It corresponds closely to the interest shown by the individual consumer in the supply of instalment credit to finance purchases of durable goods. And, since foreign trade credit is often an expensive form of short-term or medium-term borrowing, it embodies some of the same pitfalls and risks as consumer credit.

The great bulk of export credit is of a short-term nature, facilitating the movement of goods and expanding with the total value of trade. Under the influence of changes in import requirements on the one hand—greatly increasing the weight of capital goods in the flow of trade to the developing countries—and intensifying competition among exporters on the other, the supply of such credit has not only expanded in volume, but it has also lengthened in terms of average tenor, and it has probably cheapened, at least relatively, in terms of average interest rate.

The great bulk of export credit is provided privately by the parties engaged in trade—chiefly the commercial banks and the exporting concerns themselves, but also a variety of financial institutions that deal in trade bills and similar instruments. As this is one of the least documented segments of the balance of payments, it is impossible to quantify the resultant flow of credit with any accuracy. That it has probably risen steeply during the post-war period can only be inferred from the growth of trade itself and from the increase in the amount of debt that has been insured under one or other of the guarantee schemes now operating in virtually all the industrial countries.

As credit insurance is not systematically reported, it is not possible to arrive at a total of the insured credit made available to the developing countries.[14] And even if such a total could be compiled, it would not necessarily be an accurate measure of the amount of credit actually provided. Apprehension of risk by exporters, and the consequent resort to insurance, may well vary appreciably over time and from one destination to another. Moreover, both the amount and the proportion of credit insured have almost certainly risen under the influence of the changing composition of exports: the lengthening of the terms of credit has increased the need for insurance and accelerated the rise in the amount of credit outstanding.

The expansion in the exports of capital goods has also served to bring governments increasingly into the picture—not only to organize an appropriate system of insurance for the longer-term credit which is generally required for the larger items of equipment, but also to furnish the actual funds for financing the transactions themselves. Direct involvement has accentuated the tendency for governments to use credit supply and guarantee mechanisms to further their policies of export promotion. The rates of interest applicable to export credit and the facilities for discounting approved credit instruments have thus almost certainly been more favourable than they would otherwise have been. In many countries export credit has continued to be made available at the lowest commercial rate—at or near the central bank discount rate—even during periods of financial stringency when other rates have hardened. This has been most noticeable in countries—such as the United Kingdom and the United States—in which balance of payments considerations have lent special urgency to export performance.

The insurance of export credit is by no means a new phenomenon and even some of the institutions at present operating in the field have several decades of history behind them.[15] One of the earliest of the

[14] Studies of ways and means of improving the recording and reporting of export credit transactions are at present being undertaken by the IBRD and the OECD.

[15] In the early days of international trade, so-called *del credere* commissions were commonly paid to local agents for acting as guarantors of the credit of the ultimate purchasers. In the nineteenth century, a number of specialized entities were set up to insure trade credit; most ran into difficulties because they tended to become involved in the actual financing operations as well. At least one such con-

contemporary concerns was the Hermes Kreditversicherungs A.G. organized in Germany in 1917. In the United Kingdom, a private entity was set up in 1918, and the Government's own involvement through the Export Credits Guarantee Department (ECGD)—whose insurance methods have tended to serve as a model for other countries—dates from the following year. In the nineteen twenties private concerns were established in Belgium (1924), Italy (1927) and France (1928), and governments also began to provide facilities—Belgium in 1921 and later Japan (1930) and the United States (1934). Since the war, some of these institutions have been reorganized and expanded and most of the other industrial countries have established comparable agencies (*see* table II-10).

The growth of these insurance mechanisms has been bound up—as both cause and effect—with the expansion of trade, the lengthening of credit periods and the extension of coverage. The last two of these factors have been largely instrumental in drawing governments into the field: the risks are magnified very greatly as the period of credit lengthens and as political contingencies, such as import permit cancellation or the tightening of exchange controls, are taken into account as well as the more conventional contingencies of payment delays and buyer bankruptcy. And in the post-war period, these non-commercial risks have bulked very large in the case of trade with the developing countries.

The rapid growth in the turnover of most of these insurance schemes has helped to hold down costs. Indeed it has permitted downward adjustments in premiums, broadening in coverage (to include services as well as goods, for example, and to include, on a reciprocal basis, goods made partly in other countries), reduction in the minimum size of shipment eligible for guarantees and a raising of proportion of cover—in many cases to 90 per cent of the value of the transaction.

The premiums charged for insuring export credit have also been kept down by competition on the export front itself. But, as indicated above, the most notable impact of this competition (buttressed by the needs of the developing countries) has been on the provision of the credit itself. For the terms of financing tend to be regarded by the developing countries as no less important than the price of the goods being purchased, and in their efforts to promote exports the industrial countries have often been under some pressure to outbid one another in the nature of the credit being offered. Though it is not easy to measure the consequences of this competitive pressure, it is clear that it has tended to keep interest rates down and to extend the tenor of individual credit transactions.

Unless a developing country shops separately for the goods it requires on the one hand, and the means of financing the intended purchase on the other, it may often find itself unable to distinguish the cost of the credit from the price of the goods. There is much evidence that export sales sometimes hinge on the availability of credit and also that an offer of credit at a reasonable—or perhaps a relatively low—rate may serve to blunt the effect of quite a sizable apparent price disadvantage. This is particularly true in the case of many items of capital equipment whose technical complexity and often largely unknown maintenance and depreciation characteristics make price comparisons between alternative types or specifications extremely difficult. When to a seemingly low rate of interest is added a comfortably long repayment period, the terms of credit may have a considerable effect on sales.

This is not to say that there has in fact been an indiscriminate softening in export credit terms. Apart from the availability of the means of financing such credit, there have been two powerful external restraints. The subsidization of exports such as would occur if interest rates were cut to manifestly uneconomic levels is proscribed by the General Agreement on Tariffs and Trade (GATT). And various efforts have been made, most notably through the Berne Union, to prevent the undue lengthening of individual credit arrangements.[16] Members of the Union have agreed to a general limit of five years on the medium-term trade credits they underwrite—seven years in the case of certain types of aircraft and ships—and to notify the Union of any departures from this practice.

Departures from the norm have in fact been of increasing frequency in recent years. Since 1961, indeed, almost as much credit has been insured officially for periods in excess of five years as for the more regular periods of one to five years (*see* table II-11).

The total amount of trade credit accorded to the developing countries by the industrial countries and officially insured has been rising in recent years, though no faster than the over-all flow of resources —at least until 1964 when there was a very marked

cern—the American Credit Indemnity Company of New York, established in 1893—has continued in active operation, though largely in connexion with internal trade in Canada and the United States.

[16] The Berne Union—or, more properly, the Union d'Assureurs des Crédits internationaux—was founded in 1934. Its membership in 1965 consisted of twenty-six officials or government-supported export credit insurers from the following countries: Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, Finland, France, India, Israel, Italy, Netherlands, Norway, Pakistan, South Africa, Spain, Sweden, Switzerland, United Kingdom and United States.

Table II-10. Export credit guarantee schemes in the developed market economies

Country, name and status of insurance organization	Date of establishment	Capital fund (Millions of dollars)	Maximum liability (Millions of dollars)	Percentage of risk normally covered[a]: Political	Commercial	Economic	Other	Maximum length of credit normally insurable (years)[a]	Premium rates (percentage per annum)
Austria									
Oesterreichische Kontrollbank A. G. (OKB). Government trustee, owned by state and private banks	1950; started operations in 1953	Not fixed (government liability)	173	50–90	50–90	50–90	50–90	5	0.5
Belgium									
Office national du Ducroire (OND). Autonomous government corporation	1921	13.2	480	90	75	90	—	5	0.3–5.0
Cie. belge d'Assurance crédit (COBAC). Private corporation	1924	2.5	No limit	—	75–85	—	—	...	...
Canada									
Export Credit Insurance Company (ECIC). Government-owned corporation	1944; started operations in 1945	27.4	740	90	90	—	—	5	0.91
France									
Cie. française d'Assurance pour le Commerce extérieur (COFACE). Private joint-stock company	1928; in present form, 1948	6.3	No limit	Private, 90; public, 95	Private, 80; public, 80	Private, 80; public, 90	50[b]–100[c]	5	0.2–1.7
Germany (Federal Republic)									
Hermes Kreditversicherungs A.G. and Deutsche Revisions und Treuhand A.G. Private company acts as government agent	Hermes, 1917; in present form, 1949	Annual government approval	4,000	90	80	85	Preshipment manufacturing risks	5	0.3–1.5
Gerling-Konzern A.G. Private stock company	1956	3.4	No limit	—	70	—	85	5	0.5–0.8
Italy									
Instituto Nazionale delle Assicurazioni (INA). Government insurance institute	1953; started operations in 1954	Not fixed	576	85	85[d]	85	60[e]	5	0.1–1.5

Table II-10. Export credit guarantee schemes in the developed market economies (*continued*)

Country, name and status of insurance organization	*Date of establishment*	*Capital fund* (*Millions of dollars*)	*Maximum liability* (*Millions of dollars*)	*Percentage of risks normally covered*[a] *Political*	*Commercial*	*Economic*	*Other*	*Maximum length of credit normally insurable (years)*[a]	*Premium rates (percentage per annum)*
Societa Italiana Assicurazioni (SIAC)	1927	4	No limit	—	75	—	—	1	0.3–1.5
Japan									
Export Insurance Section, International Trade Bureau, Ministry of International Trade and Industry (MITI)	1930; present system, 1950	1.5	Government sets limits annually	90	90	90	—	No fixed limits	0.1–0.6
United Kingdom									
Export Credits Guarantee Department (ECGD). Government department	1919; present system, 1949	Not fixed	4,200 for commercial guarantees, plus 3,600 for national interest transactions	90–95	90	90–95	90[b]	5–7	0.28–4.5
Trade Indemnity Company (TIC). Private company	1918	3.8	No limit	—	75–80	—	—	5	Variable
United States									
Foreign Credit Insurance Association (FCIA). Unincorporated private association	1962	Not fixed	No limit	90–95	90	—	—	5–7	...
Export-Import Bank (Eximbank). Government-owned	1934; reorganized 1945	1,000 plus 6,000 authority to borrow from Treasury	9,000						...

Source: International Export Credit Institute, *World's Principal Export Credit Guarantee System* (New York, 1965); United Kingdom, *Board of Trade Journal* (London), 7 May 1965; United States Department of Commerce, *International Commerce* (Washington, D.C.), 11 January 1965; United States Export-Import Bank, *Report to the Congress for the twelve months ended in June 1965* (Washington, D.C.); *The Banker* (London), December 1965; *The Economist* (London), 11 December 1965; *Neue Zürcher Zeitung*, 28 May 1965.

[a] Most institutions have provision for higher and longer-period coverage in exceptional cases.

[b] Of losses incurred in export market promotion.

[c] Of losses resulting from increases in production costs (in excess of 20 per cent in the case of France) on fixed-price export contracts.

[d] For public exports as from 1966.

Table II-11. Industrial market economies: Total of officially guaranteed private export credits to less developed countries,[a] 1956-1964

(Millions of dollars; percentage)

Year	Credit extended for: More than one year: Amount	More than one year: Percentage of total capital flow[b]	One to 5 years	More than 5 years
1956	395	6	322	73
1957	430	6	145	285
1958	170	2	143	27
1959[c]	316	4	307	9
1960[c]	463	6	369	93
1961[c]	493	5	273	221
1962	549	6	255	293
1963	556	6	308	248
1964	816	9	411	404

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on Organisation for Economic Co-operation and Development, *The Flow of Financial Resources to Less Developed Countries*, for the years 1961 and 1956-1963, and *Development Assistance Efforts and Policies, 1965 Review, Report of the Chairman of the Development Assistance Committee.*

[a] Developing countries, plus credits extended by members of the OECD to Cyprus, Gibraltar, Greece, Malta, Spain, Turkey and Yugoslavia.

[b] Official bilateral and multilateral, plus private bilateral and multilateral including officially guaranteed private export credits of over one year.

[c] Excluding officially guaranteed private export credits of the United States, probably small in total

upswing. The relative importance of officially insured credits has risen most noticeably in Belgium, France and Switzerland and, on a smaller scale, in the Netherlands, Norway and Sweden (*see* table II-12). In the Federal Republic of Germany they have registered a steep decline, both absolutely and in relation to other types of resource transfer. In absolute terms they have bulked larger in Italy and the United Kingdom, and in Italy they have also constituted a sizable proportion—about one-third in 1962-1964—of total transfers to the developing countries. Their role has been much greater in Europe than in North America or even Japan. Indeed, it has been their relative insignificance in the United States that has held down their average for the industrialized market economies as a group to about 6 per cent of the over-all outflow of resources.

From the recipients' standpoint the availability of trade credit is a great advantage as a second line of reserves adding appreciably to effective liquidity. It is a relatively short-term and high-cost source of finance, however, and for an individual developing country it entails certain risks. It is generally "rolled over" on a continuing basis and is likely to grow at approximately the rate at which imports themselves are increasing. The higher the proportion of imports financed on such credit the more difficult it is likely to be to effect a sudden adjustment such as developing countries have in the past often been required to make in the face of an unexpected short-

Table II-12. Industrial market economies: Officially guaranteed private export credits to less developed countries, by country,[a] 1956-1964

(Millions of dollars; percentage)

Country	Credit of over one year extended in: Annual average, 1956-1958: Amount	Annual average, 1956-1958: Percentage of total flow[b]	Annual average, 1959-1961: Amount	Annual average, 1959-1961: Percentage of total flow[b]	Annual average, 1962-1964: Amount	Annual average, 1962-1964: Percentage of total flow[b]
Austria	1	100	6	67	5	26
Belgium	—	—	17	10	28	18
Canada	6	5	—	—	8	6
Denmark	..	.	17[c]	50[c]	6	32
France	35	3	100	8	124	9
Germany (Federal Republic)	144	29	131	17	88	13
Italy	50	32	38	16	105	32
Japan	9	5	30	11	26	9
Netherlands	2	1	24	11	14	11
Norway	—	—	1	11	3	14
Portugal	—	—	—	—	—	—
Sweden	1	5	7	15	9	18
Switzerland	5	5	33	23	76[d]	47[d]
United Kingdom	87	12	27	3	113	15
United States	—8	—[e]	...		42	1

Source: As for table II-11, and Special Questionnaire issued jointly by the United Nations Secretariat and the International Monetary Fund.

[a] From OECD member countries to developing countries plus Cyprus, Gibraltar, Greece, Malta, Spain, Turkey and Yugoslavia

[b] Official bilateral and multilateral, plus private bilateral and multilateral including guaranteed export credits of over one year.

[c] 1960-1961 average.

[d] 1962-1963 average.

[e] There was a net repayment of guaranteed export credits during this period.

fall in export receipts. For though the tightening of import controls can normally be expected to result in a cut in future liabilities in a matter of months, the burden of meeting maturing trade debts incurred some years before has still to be faced. The difficulty is sometimes compounded by the absence of any complete and systematic record of this type of debt. And experience in recent years has shown that the problem of debt management can be seriously accentuated by the accumulation of a relatively large burden of short-term and medium-term obligations arising from the purchase of ordinary imports which may not add too significantly to the country's export earning capacity.[17]

[17] This problem is taken up again in chapter III in the context of the over-all debt of the developing countries.

Direct government involvement with resource transfers

Government involvement with the transfer of resources has long been implied in the colonial relationship that some of the developing countries have had with various developed market economies. By contemporary standards, however, the financial involvement was normally a fairly restricted one: it consisted chiefly of what would now be regarded as a form of technical assistance. But the skills that the metropolitan Power provided were paid for, at least in most cases and in ordinary times, from the revenues raised by the dependency itself. Apart from an occasional budgetary subvention and the underwriting and guarantee of loans floated by the dependency on the metropolitan capital market, official transfers of resources were minimal.

Since the war this relationship has undergone a major revolution, involving not only the position of the developed market economies vis-à-vis their former dependencies but all the lower-income countries regardless of their political status. The revolution was a dual one, affecting attitudes and policies towards economic development on the one hand and international responsibility and solidarity on the other. The ideas were expressed in the Atlantic Charter during the war and subsequently in the United Nations Charter, and given practical meaning in the operation first of the United Nations Relief and Rehabilitation Administration (UNRRA) and then of the European Recovery Programme.

These were exercises in reconstruction, but there was an early spill-over into the field of development. The United States launched a large-scale rehabilitation and development programme in the Philippines, and a smaller and more diffused general technical assistance programme known, from the Presidential speech that inaugurated it, as Point Four. The United Kingdom revamped its Colonial Development and Welfare Act: the funds earmarked for the purpose were expanded from the original £1 million a year denominated in 1929 and the £5.5 million a year provided in 1940 to the sum of £120 million, to be used over the period 1946-1956.[18] In 1946, France created an Investment Fund for the Economic and Social Development of the Overseas Territories—Fonds d'Investissement pour le Développement économique et sociale (FIDES)—administered financially by the Central Bank of France Overseas—Caisse centrale de la France d'outre-mer (CCFOM)—and, in the course of the two five-year plan periods after this machinery had come into operation, the equivalent of $2.6 billion was committed for use in the French Union.

From these beginnings in the nineteen forties a new and complicated government mechanism has evolved, not only in the three countries which by reason of status and history felt special obligations towards the developing countries but also in most of the other developed market economies. The nature of the machinery that has been built up has differed from one country to another. In the smaller countries it has been geared chiefly to operations with and through various international agencies. In the Federal Republic of Germany, Italy and Japan, it has been shaped in part by reparations arrangements with Israel, with Ethiopia and Somalia, and with Burma, the Federation of Malaya, Indonesia and the Philippines, respectively. Also formative in the case of the Federal Republic of Germany was the Government's increasing assumption during the latter part of the nineteen sixties of responsibilities in connexion with the financing of the Rourkela steel plant in India, in its initial stages a private undertaking. In some countries, forms of administration have been determined in large measure by special relationships with particular under-developed areas—Australia with New Guinea, Belgium with the former Belgian Congo, Portugal with Angola and Mozambique.

[18] The Act was revised again in 1965 and the amount provided again increased. Actual expenditures under this particular budgetary head rose from less than £4 million in 1946/47 to over £20 million a year in the early nineteen sixties.

In France and the United Kingdom, the development of transfer mechanisms has been influenced strongly by changing relationships to the main recipients, in the Union and the Commonwealth, respectively. In the United Kingdom the need to broaden the frame of reference of the colonial development and welfare arrangements became increasingly urgent and was formally recognized in 1958 at the Commonwealth Conference in Montreal when the machinery for financial aid was extended to members attaining independence. A similar transition occurred in France with the passage of the Financial Act of 1960. The manner in which France has transferred resources to the rest of the Union has also been affected by the evolution of the EEC which has set up a joint European Development Fund (EDF) for making loans and grants to associated countries. Implementation of the trade provisions of the Treaty of Rome has also necessitated important modifications in the system of commodity price supports through which one type of transfer—referred to earlier in this chapter—has traditionally been made to France's trading partners.

In the United States the machinery for technical co-operation set up under the Act for International Development of 1950 soon fell under the shadow of the Mutual Defense Assistance Program which had been launched in 1949. Much of the assistance to developing countries—especially in Asia—in the first half of the nineteen fifties was motivated by security considerations and took the form of defence support. A new element was added with the passage of the Agricultural Trade Development and Assistance Act in 1954. More commonly known as PL 480, this measure served to marry the wheat and other farm surpluses which were beginning to emerge in the United States with the food shortages which were becoming increasingly disruptive of the developmental plans of a number of countries. A similar purpose was served by the Mutual Security Act of 1954, section 402 of which made provision for the sale of United States agricultural surpluses against the currencies of recipient countries. A further swing away from security considerations occurred in 1957 with the setting up of a Development Loan Fund. This was followed in 1960 by the organization of a new regional scheme for channelling resources to Latin America—the Alliance for Progress—and in 1961 by a regrouping of responsibilities for the various types of transfer in an Agency for International Development (AID).

By the beginning of the nineteen sixties, thus, virtually all of the governments of the developed market economies had gone well beyond the promotion and support of private resource transfers in different forms. They had created machinery for effecting not only financial transfers but in many cases the transfer of a range of physical resources also.

As indicated earlier in this chapter, the need for these publicly organized transfers reflects in part the rapid deterioration in the external balance of the developing countries in the second half of the nineteen fifties and in part the failure of private flows to expand. In the aggregate, bilateral public transfers from the developed market economies to the developing countries doubled between 1956 and 1963, and the form in which they were made registered a marked change: the proportion in the form of grants dropped from almost two-thirds of the total in the early years to less than half in the later years, while the proportion passing as loans almost doubled, reaching about one-third in 1963-1964 (*see* table II-13).

Not all these loans were repayable in convertible currency: the United States has lent sizable sums repayable in the currencies of the recipient countries. Nevertheless, the proportion of convertible currency loans did rise—from about 19 per cent in 1956-1958 to about 29 per cent in 1962-1964. And as the United States has continued to favour the move away from grants, the loan ratio is still rising.

As indicated above, the United States has also transferred a large volume of farm produce, mostly in return for local currency, much of which has subsequently been put at the disposal of the developing country. As a proportion of the total outflow from the developed market economies, such sales have fluctuated erratically between one-eighth and one-fifth, and in 1964 they exceeded $1 billion for the first time.

While a number of the smaller sources of capital have continued to make virtually all their transfers to the developing countries as grants—most notably Australia, Belgium and, on a smaller scale, Switzerland and the Scandinavian countries—there has been a general disposition among the larger sources to increase the proportion in loans. The proportion of grants was lower in 1962-1964 than in 1956-1959 not only in the United States but also in Canada, the Federal Republic of Germany, Japan, the Netherlands and the United Kingdom. Italy transferred more in grants in 1962-1964 but the volume of its lending was reduced, to that it was alone among the developed market economies in registering an over-all decline in the amount provided from public funds. France also provided relatively more in grants in 1962-1964, but the rate of increase in total outflow was well below the average, so that the French contribution to the total transferred bilaterally from the developed market economies through official channels

Table II-13. Developed market economies: Total net bilateral public transfers to developing countries, 1956-1964

(Millions of dollars)

Year	Total, bilateral	Grants	Sales of commodities for recipients' currencies	Loans, repayable in: Recipients' currencies	Loans, repayable in: Convertible currencies
1956	2,607	1,706	408	25	468
1957	3,034	1,898	621	64	451
1958	3,645	2,285	457	90	813
1959	3,540	2,120	498	160	762
1960	3,982	2,392	807	191	592
1961	4,803	2,697	713	197	1,196
1962	5,031	2,649	790	315	1,277
1963	5,294	2,613	894	228	1,559
1964	5,271	2,553	1,036	207	1,475

Source: See table II-1, the foot-notes to which define the flows that have been included.

dropped from about one-fourth in 1956-1958 to less than one-sixth (*see* table II-14).

ADMINISTRATIVE AND FINANCIAL PROBLEMS

The rapid intensification of government involvement in the provision of various types of resources for use in developing countries has raised two sets of interconnected problems, one administrative and the other financial. The problems of administration grow out of the sheer complexity of the "foreign aid" exercise: it embraces not only the widening of physical and accounting transactions referred to above but also the whole nexus of intergovernmental relations—economic, political and in some cases military as well—and arrangements for projecting and responding to the impact of the transfers on the domestic economy and in the various recipient countries. The problems of finance grow out of dependence on budgetary provisions and the constraints that are implied in this when "foreign aid" competes for funds with an expanding array of internal claims on public revenue.

Though the setting up of a ministry or department dealing with "international development" or "economic co-operation"—as has been done in most of the major sources of capital—has made it possible to see the problems in proper focus and effect some co-ordination, the difficulties in the way of optimizing the effectiveness of transfers to the developing countries remain formidable. Even with the abandonment of a global approach and the concentration of the programme on a small number of developing countries—a distinct and fairly general tendency—it has proved far from easy to bring the necessary expertise from the many relevant regional and functional units in government and from the private sector to bear on the problems of effective utilization of the resources that have been made available. And where the conviction has grown that those resources have not always been used to the best advantage, the difficulty of securing them through the budget has been accentuated. In this way, where allocations are made on an annual basis the elements of a vicious circle have tended to emerge.

Governments administering sizable "foreign aid" programmes have thus found themselves in an ambivalent situation. In order to obtain funds for the programme, it has frequently been found expedient to stress to the legislature and the public at home aspects of it—such as the relative smallness of the sums involved, the link with exports, the fact that the aid programme may be conditional on the performance of the recipient or that it may be intended to achieve certain political or military advantages—which tend to be regarded as irrelevant or even detrimental by recipient countries.

This is in part a reflection of the newness of the operation. The post-war record of public response to the challenge of international economic situations has in many respects been extraordinarily good: the degree of co-operation in evidence among the developed market economies, the absence of the sort of "beggar-my-neighbour" attitudes that marred so much of the interwar period, and the many manifestations by individual governments of their capacity to envisage the global good have all served to create a favourable atmosphere for foreign aid. To a large degree, however, the greater sophistication of legislatures has been offset by the diversity and complexity of the development problem itself and an underlying uncertainty about what can be done about it from the outside. The feeling that the real obstacles to growth are internal and often deeply rooted in resource deficiencies, or in ill-adapted institutions that are not amenable to rapid change, has given

Table II.14. Developed market economies: Net bilateral public transfers to developing countries, by country,[a] 1956-1958 to 1962-1964

(Millions of dollars)

Country	Average, 1956-1958 Total	Grants[b]	Loans	Average, 1959-1961 Total	Grants[b]	Loans	Average, 1962-1964 Total	Grants[b]	Loans
Australia	37	37	—	56	55	1	85	84	1[c]
Austria	—	—	—	—	—	—	4	1	2
Belgium	11	11	—	63	63	—	73	73	—
Canada	51	39	12	49	50	—1	81	47	34
Denmark	—	—	—	1	1	—	1	2	—1
France	768	604	164	815	720	95	834	701	133
Germany (Federal Republic)	103	63	40	202	73	128	349	132	218
Italy	70	16	54	58	27	31	60	23	37
Japan	148	107	41	155	68	87	172	74	99
Netherlands	25	21	4	29	27	2	33	22	11
Norway	1	1	—	1	1	—	2	2	—
Portugal	2	—	2	30	2	28	52	7	45
Sweden	1	1	—	1	1	—	7	6	1
Switzerland	—	—	—	1	1	—	2	2	—
United Kingdom	158	98	61	318	148	170	372	201	170
United States	1,715	1,518	197	2,324	2,018	306	3,069	2,382	687
Total[d]	3,096	2,519	578	4,107	3,257	849	5,198	3,761	1,436

Source: See table II-1.

[a] For definitions of country and flow coverage, *see* table II-1.

[b] Including sales and loans against recipients' currencies.

[c] Average, 1962-1963.

[d] Countries listed, plus Finland, New Zealand and South Africa.

rise to grave doubts about the efficacy of financial transfers and about the ability to provide technical assistance where so much is unknown. Every reported failure and every documented case of waste or mismanagement or misallocation of resources have strengthened such feelings and added significantly to the difficulties of governments seeking budgetary authorization for aid programmes.

In many ways the impact of these doubts and difficulties has been salutary. The advocates of "foreign aid" are more modest in their claims now than was sometimes the case in the nineteen fifties. There is a healthy recognition of the broad spectrum of obstacles to economic development and less tendency to regard external finance as the only means of dealing with them. The result has been an intensified emphasis on research and the evaluation of experience and an increase in the number of seminars, conferences and study groups, and a corresponding weakening in the facile belief that the transfer of money or of institutions and technology functioning in one or other of the developed market economies will automatically result in the acceleration of the development process.[19] There has also been an increase in the amount and means of consultation with the developing countries both on an *ad hoc* basis and in the more formal framework of aid consortia, consultative groups, and entities such as the Inter-American Committee of the Alliance for Progress

[19] Illustrative of the critical re-thinking that has been occurring during the past few years is the work undertaken by the Development Centre of the OECD. The latest of the studies published by the Centre carries the title *Foreign Aid Policies Reconsidered*, by Goran Ohlin (Paris, 1966). *See* also United States, Agency for International Development, *Principles of Foreign Economic Assistance* (Washington, D.C., 1963); United Kingdom, Her Majesty's Treasury, *Aid to Developing Countries*, Cmd. 2147 (London, 1963); France, Ministère d'Etat, *La Politique de coopération avec les Pays en voie de développement*, by Jean-Marcel Jeanneney (Paris, 1963). Also indicative of the new search for answers to some of the unsolved transfer problems is the spread of interest not only among scholars but also in various private groups and institutes. Notable among these is the Overseas Development Institute in London which has published a series of surveys of national foreign aid policies and of foreign aid in action in various countries. *See* also the Research Project of the Columbia University School of Law on "Public International Development Financing", which has issued several studies, as well as such entities as the National Citizen's Commission in the United States, a report of whose Committee on Technical Co-operation and Investment was published in December 1965, and the International Economic Association, which held a Round-table Conference on "Capital Movements and Economic Development" in July 1965. Among the recent conferences that reveal the widespread interest and concern was one organized by the German Foundation for Developing Countries on "International Co-operation in the field of Documentation of Development Assistance" (October 1964), one sponsored by the French Direction des Affaires économiques et financières du Ministère de la Coopération to discuss "The Utilization by Developing Countries of External Supplies, Technical Assistance Personnel and Capital Aid" (May 1965), and one organized by the Japanese Economic Research Centre on "Measures for Expansion of Developing Countries".

(CIAP). This is designed to facilitate the process of integrating external finance with the resources that are available domestically. It has become increasingly clear that public resource transfers are not the equivalent of private direct investment for whose slow and erratic growth they have sought to compensate. Though some transfers have been effected through public direct investment by such mechanisms as the Commonwealth Development Corporation—which, though drawing some of its funds from the United Kingdom Exchequer, operates in a full entrepreneurial capacity—the great majority of public flows are not pre-integrated in production combinations. On the contrary, for the most part they comprise discrete and readily distinguishable components, separately arranged and provided at different times and on different terms. The result is not a balanced package capable of being readily combined with complementary local factors into a viable productive enterprise. Nor is it a steady flow of usable cash that might be converted into specific combinations of factors by purchases on the market. Consisting, as they have in recent years, of the unco-ordinated transfer of various types of goods and services plus loans and grants whose use may be circumscribed in various ways, these public flows pose major utilization problems.[20]

Short of the ideal flow of untied grants in convertible currencies—which, given wise planning on the part of the developing countries and the absence of imbalances among the developed market economies, would be the optimal way of sharing resources—there is always likely to be a co-ordination and absorption problem. Transfer machinery now evolving is designed to reduce the difficulties by bringing to light as promptly as possible shortcomings in the pattern of transfers. The deficiency most commonly discovered so far has been the inadequacy of resources usable in a flexible manner for the acquisition of raw materials or components or for general balance of payments support. But a shortage of specific skills has also created utilization problems from time to time and some public lending mechanisms now provide access to technical assistance such as might be required for the most effective deployment of the loans they make.

By endorsing recommendation A.IV.2 of the first UNCTAD, the developed market economies accepted a target for the over-all transfer of resources. Though public transfers constitute the bulk of the total in most countries, the implications of this target have not affected financial procedures in most countries: the fact that governments will need to be provided with resources for implementing it has not led to many budgetary commitments of a forward nature. In the United Kingdom the early Colonial Development and Welfare Act involved a ten-year pledge, but recent versions of this measure have shortened the period—to five years in 1955 and 1959 and to three years in 1963—and in any case this represents only one form in which resources are made available to the developing countries. In the United States the five-year pledge in 1948 to support the ERP has not been repeated in connexion with later foreign aid authorizations. Only the Development Loan Fund in 1957 was given more than a one-year life, and beyond allowing unspent appropriations to be brought forward in 1958, this was not repeated. Norway is the only country to earmark tax revenues for development aid purposes: since 1964, 0.25 per cent of personal income has been set aside in this way. While the principle of identifying individual citizens with the international effort seems to have been well received, the resultant revenue is small by most standards.

One escape from the constraints implicit in annual budgetary authorizations lies in the greater use of the capital market. To some extent the loans that governments make to the developing countries are derived from their own borrowings from the public. By lending at or near the same interest rate at which it can borrow, the government is making funds available to the developing countries on terms appreciably more favourable than those on which the latter could themselves borrow. In some cases, however, even this may not be favourable enough, and governments have used appropriations from ordinary revenue to make good losses incurred by official lending agencies on loans made to developing countries at submarket rates.

The need for systematizing and extending the various means for tapping the private capital market referred to earlier in this chapter has become more urgent as the rate of increase in the provision of public funds has slackened. The inherent difficulties in obtaining budgetary authorizations on an increasing scale have been accentuated in recent years by the imbalances that have emerged in the developed market economies, particularly in the United Kingdom and the United States, but also at times and in varying degree in Canada, Italy and Japan. It is extremely difficult for a government which is calling for stringent measures to reduce external expenditures and curb the outflow of capital simultaneously to ask parliament to increase the amount voted for foreign aid. Thus, the movement of resources to the developing countries tends to become the victim of disequilibria in transactions of the developed market economies with one another. This suggests that the mechanism for tapping the capital market is likely to be more effective if operated multilaterally than if confined within national boundaries.

[20] Some of these utilization problems are discussed in the following chapter, along with steps that might be taken by the developed market economies to mitigate them.

Annex

Table A.II-1. Net bond issues in developed market economies, 1962-1964

(Millions of dollars)

Country and year	Domestic issues: Public: Central government	Domestic issues: Public: Local authorities and public bodies	Domestic issues: Private[a]	Foreign issues	Total
Belgium					
1962	360	231	258[b]	6	855
1963	58	144	220[b]	2	423
1964	159	258	116[b]	—	533
Denmark					
1962	—26	—	381	—	355
1963	—28	—	496	—	469
1964	—25	—	548	—	523
France[c]					
1962	—176	16	865	—	706
1963	426	31	1,004	12	1,473
1964	112	35	1,110	31	1,288
Germany (Federal Republic)					
1962	165[d]	453	1,766	25	2,409
1963	453[d]	448	2,133	28	3,062
1964	380[d]	450	2,562	224	3,616
Italy					
1962	—176	276[e]	1,586	48	1,734
1963	—321	207[e]	1,838	22	1,746
1964	—13	254[e]	1,954	—	2,196
Netherlands					
1962	—25[f]	56	83	39	153
1963	169[f]	111	—6	—33	242
1964	53[f]	81	39	—14	159
Spain					
1962	8	82	185	—	274
1963	83	143	345	—	572
1964	250	139	332	—	722
Sweden					
1962	46	60	594	—	700
1963	362	67	375	—	804
1964	21	111	571	—	703
Switzerland[g]					
1962	—53	42	257	102	347
1963	—76	60	508	123	614
1964	—37	153	489	65	670
United Kingdom					
1962	1,598[h]	392	476	—	2,467
1963	—336[h]	252	671	56	643
1964	—307[h]	251	781	167	893
United States[i]					
1962	1,257[j]	4,603	4,865	1,048	11,773
1963	2,509[j]	6,007	5,344	1,045	14,905
1964	823[j]	5,403	6,097	720	13,043

Table A.II-1. Net bond issues in developed market economies, 1962-1964 (*continued*)

(*Millions of dollars*)

Country and year	Domestic issues: Public: Central government	Domestic issues: Public: Local authorities and public bodies	Domestic issues: Private[a]	Foreign issues	Total
Canada					
1962	714[k]	863	390	—	1,967
1963	907[k]	1,203	518	—	2,627
1964	186[k]	1,266	652	—	2,104
Japan					
1962	—11	712	1,122	—11	1,812
1963	44	981	1,483	14	2,522
1964	50	1,147	1,574	17	2,788
Total					
1962	3,682	7,785	12,828	1,257	25,551
1963	4,250	9,654	14,931	1,268	30,102
1964	1,654	9,548	16,826	1,210	29,237

Source: Bank for International Settlements, *Thirty-fifth Annual Report*, for the period 1 April 1964-31 March 1965 (Basle, 14 June 1965).

[a] Including issues of semi-public credit institutions and nationalized industries.

[b] Including deposit-bank issues of medium-term savings bonds.

[c] Franc zone bond issues are included with domestic issues.

[d] Change in market holdings of bonded loans and premium Treasury bonds.

[e] Including indirect Treasury borrowing.

[f] Excluding payments into pre-subscription accounts.

[g] Including privately placed issues.

[h] Change in marketable debt (excluding Treasury bills) in public hands.

[i] Based on Federal Reserve flow-of-funds data, excluding mortgage loans.

[j] Change in public holdings of marketable debt having a maturity of one year or more.

[k] Held outside government accounts.

Chapter III

SOME PROBLEMS OF EXTERNAL FINANCE

Two of the characteristics of the resource flows discussed in the previous chapter have proved to be particularly troublesome. The fact that the transfers are not all in a freely usable "liquid" form but are for the most part either in goods and services or in restricted types of credit has given rise to various utilization problems. And the tendency for the amount lent to grow more rapidly than the amount given has accentuated the problem of debt and its servicing.

The tendency towards specificity in the transfers is in part a reflection of the increase in the number of forms in which they are made. Compared with the cash borrowing of an earlier period, the post-war growth of flows-in-kind has tended to reduce the ability of the recipient to use the external resources flexibly as an increment to general purchasing power. More recently, even cash flows have been subjected increasingly to constraints as to their use, as individual developed market economies have sought to protect their own balance of payments from the full impact of the loans and grants they have made. Apart from such "tying" of the transfers, there has been a strong and general tendency to lend funds or make donations for specific purposes—usually well-defined capital projects—rather than for general use at the discretion of the recipient.

The imposition of these various restraints is a contagious process: as more source countries engage in them, it becomes more difficult for other countries to abstain. Contrariwise, if relaxation is to be achieved, it needs to be tackled multilaterally.

In principle, from the point of view of the developing country, any constraint on freedom of use might be expected to detract from the value of the transfer. In practice, however, the needs of many developing countries are so broad and their administrative and technical services frequently so weak, that certain resources received in kind or in the form of complete capital projects may in fact be just as useful for their economic development as would be freely disposable purchasing power. In some cases, indeed —most notably in the transfer of knowledge and expertise in the form of what is generally called "technical assistance"—developing countries would find it extremely difficult to obtain their requirements by means of a conventional market transaction.

The difficulties arise when the pattern of resource transfers does not accord with well-defined priorities, and when constraints on the use of cash serve to raise costs or restrict choice to an undue extent. Moreover, because of the general scarcity of foreign exchange among the developing countries, the problem of effective utilization of externally provided resources becomes increasingly serious as the proportion of freely disposable receipts diminishes. Where most of the incoming resources are destined for particular investments or are in the form of specific goods and services, it may prove difficult to integrate them to the best advantage with the available domestic resources in the framework of a development plan.

The growth of external debt aggravates the situation by further reducing the freely usable purchasing power at the disposal of the developing country, pre-empting an increasing amount for purposes of interest and amortization. The growth of debt poses problems for the creditor countries, too: they are concerned with the solvency of the debtor not only in connexion with repayment and with the relationship of their claims but also in connexion with the status of the debtor as a future purchaser of their exports.

There is thus a strong mutual interest between creditor and debtor and among the various creditors to keep the debt of developing countries down to manageable proportions. This is a question not only of the absolute magnitude of the debt and the interest rate it carries but also of the distribution over time of its repayment. But the problem transcends that of the terms on which loans are made: it involves the purposes for which the borrowing is undertaken and their effect on the debt servicing capacity of the borrowing country. To prevent debt accumulation from becoming a disruptive force is a joint responsibility of lender and borrower.

Project financing

A "project" in the present context is a more or less self-contained capital investment, considered separately even though it may be a constituent element in a development programme or plan. As a distinct entity, capable of being costed with some precision and of being broken down into components and functions with definable sources and sequences, it lends itself naturally to a discrete financing operation. As such projects usually involve specific imported equipment and often the knowledge and skills required for its erection and commissioning as well as, in greater or less degree, other direct foreign exchange costs, they have long constituted a major means of harnessing external finance to the development process.

Virtually all the loans made by the centrally planned economies to the developing countries are for the financing of specific projects. An analysis of commitments entered into by the developed market economies and the international agencies in 1962 and 1963 shows that about one-third of the amount pledged bilaterally and almost 90 per cent of the amount pledged by the agencies was for the financing of defined capital projects.[1]

Project financing is a convenient mode of international capital transfer. It tends to be favoured by the source country—and also by the multilateral lending agencies—because it is measurable both as a commitment and in terms of its execution, which yields tangible evidence of the financial outlay, phase by phase to completion. Not only is the project itself physically and financially definable, but—at least in principle—its relationship with other projects and with the economy as a whole may be readily appraised, its viability assessed, its contribution to the recipient country's debt servicing capacity evaluated. These features commend this form of financing to many developing countries, too. Developing programmes often consist of a series of individual investments and it is not necessarily inconvenient and, where technical assistance is involved, it may actually be advantageous to arrange for their separate financing. And the economic justification of the project and its linkage to the rest of the economy are matters no less important to the capital importing country than to the capital exporter. In its most rudimentary form, indeed, development planning entails the setting of priorities for just such projects against a background of appropriate economic policies and the required arrangements in the rest of the economy.

In recent years, however, evidence has accumulated that the separate financing of individual capital projects, when it embraces a high proportion of total cash transfers, is a potentially restrictive procedure introducing some risks for the efficiency of the economy as a whole. The reason for this lies mainly in the tendency to define the individual project too narrowly, not taking adequately into account its relationship to other projects and to the rest of the economy, and to make insufficient allowance for the borrowing country's need for working or uncommitted capital. The demand for imports associated with a given project is not limited to the equipment and components and materials actually embodied in the investment itself: it spreads to other parts of the economy both during the period of capital formation when other resources are being absorbed and subsequently when the project is operating and generating new income. The provision of resources for financing this indirect demand is rarely adequate, and experience has shown that the higher the proportion of a development programme financed on a narrowly defined project basis the greater is the danger that foreign exchange needs will be underestimated. The resultant shortage of exchange may give rise to bottle-necks and the tightening of import controls, and even to the anomaly of new plants being erected on additional project finance while existing plants operate well below capacity because of shortages of imported components or raw materials.

This sort of difficulty has been apparent in India throughout its second and third plan periods. Pleas made at meetings of the financing consortium for an increase in the amount of unattached lending have helped to ease the situation but industrial utilization ratios have remained low. A recent survey suggests that among the larger manufacturing units the proportion of industrial categories operating at reasonable economic rates of capacity remains very low. In 1964, for example, less than two-thirds were working at more than 70 per cent of capacity, and over the period 1957-1964 well below half of the industries achieved an operating rate of 80 per cent or more (*see* table III-1). Moreover, among the smaller units underutilization of plant was even more marked. Though by no means the only cause of low operating ratios, difficulties associated with the foreign exchange stringency bulk very large.

Another risk connected with this type of financing lies in the nature of the project. Not all projects are equally attractive to the capital exporting countries: there is always likely to be preference for those which fit in best with export availabilities, and for those which are most obviously viable as individual entities, and sometimes there is a preference for prestigious investments. Consequently, the projects for which financing can be arranged do not always

[1] *See* Organisation for Economic Co-operation and Development, *The Flow of Financial Resources to Less Developed Countries, 1956-1963* (Paris, 1964), table II-13.

Table III-1. India: Rate of capacity utilization in selected industries,[a] 1957-1964

(Cumulative frequency; percentage)

Production as percentage of installed capacity[b]	*1957*	*1958*	*1959*	*1960*	*1961*	*1962*	*1963*	*1964*
100 per cent or more	20	17	21	25	28	23	27	27
90 per cent or more	24	24	28	35	34	33	40	42
80 per cent or more	32	35	35	43	49	47	53	57
70 per cent or more	49	44	48	53	61	61	63	64
60 per cent or more	55	56	61	64	75	76	78	73
50 per cent or more	67	72	74	78	82	83	87	88
40 per cent or more	78	81	83	87	88	90	91	89
30 per cent or more	85	90	91	94	95	95	95	95
20 per cent or more	90	95	94	97	97	97	98	97
10 per cent or more	95	98	98	98	99	99	99	99
Zero per cent or more	100	100	100	100	100	100	100	100

Source: Government of India, Cabinet Secretariat, Department of Statistics, Central Statistical Organization, *Monthly Statistics of the Production of Selected Industries of India for June 1965* (Calcutta, 1965).

[a] Based on a sample of 204 industrial categories, excluding smaller units for which data are inadequate.

[b] Production figures are based on monthly averages. Installed capacity refers to the close of the period.

accord precisely with the priorities dictated by a sound development policy. When the developing country does not have the means for financing other projects, bottle-necks and imbalances may emerge and its development programme may be retarded. At stake here is not only the use of external finance but the deployment of all the domestic factors of production which are normally required to complement the imported skills and equipment.

The impact of the choice of project is increased by the fact that on the whole it is the larger investments which tend to be considered for external finance, both bilaterally and through the multilateral agencies. Between 1956 and 1965, for example, the 166 projects that the International Bank for Reconstruction and Development (IBRD) financed in its twenty-eight principal debtor members, involved an average amount of over $20 million—a sizable sum for most developing countries.

Some of the difficulties that project financing has tended to occasion may be avoided or mitigated by a joint approach: this is one of the lessons being learned in the so-called "aid consortia" and "consultative groups" that have been established in recent years. Within the framework of an entity of this nature it may be possible to align more closely the criteria adopted by borrower and lender for evaluating viability and setting priorities. The lender's tendency to take too narrow a view of individual investments can be modified when a borrower is able to expound the country's development strategy, demonstrate the interrelationship among projects and explain the determinants of project size and timing.

The more synoptic view emerging from such confrontations has begun to introduce greater flexibility into financing arrangements. In June 1964, the International Development Association (IDA) granted its first general credit to India—$90 million to finance imports for various capital goods industries, in order to permit a rapid and sizable expansion in the output of commercial vehicles, machine tools and electrical and construction equipment. This was followed by a further $100 million in 1965. There has also been some relaxation of the earlier general rule that external finance should cover only the foreign exchange costs of the project in question. It has become increasingly evident that, quite apart from the indirect expansion in import demand that a given investment may induce, there may be strains on other resources which, unless relieved, could be inimical to the development process.

Though, because of its advantages for measurement and control, the project is likely to continue to be the main basis for the negotiation of external finance, there is a perceptible softening of the rigid accounting approach which until recently has governed this type of flow. There is new evidence of a willingness to see the individual project in its proper economic setting in terms both of its initial cost and of its longer-run role in the recipient country's development. There would seem to be no reason for adhering to a narrow definition of "project". It should not be too difficult to devise appropriate means of measuring the need for specific components, spare parts, replacement equipment or other inputs, lack of which may be causing poor capacity utilization. Nor should it be too difficult to exercise as much control over shipments of this nature as over those of the various elements of a traditional "project".

The problem of tying

Akin in many ways to the constraint implicit in the financing of particular projects is the tying of funds to particular procurement sources or to particular commodities. Tying by source and tying by end-use are quite separate limitations, though a particular flow may be subject to both.

The most obvious form of tying is by means of a contractual obligation limiting the procurement to a particular source. Grants or loans tied in this way are made with explicit stipulation of where they may be spent, and possibly subject to further limitations with respect to the types of commodities which may be purchased. In order to ensure strict adherence to the geographic restriction on procurement, such loans and grants are usually disbursed on the presentation of certified documentation of export.

In one sense, most forms of export credit are also tied, that is, they are intended to finance the purchase of goods from a given country. In many cases, however, the tying may be largely incidental: the buyer may have selected the goods after due comparisons and before availing himself of the credit in question.

In another sense, all transfers-in-kind are tied: they are specified in terms of actual commodity and in practice as far as most bilateral transfers are concerned, also in terms of source of procurement. Here again, however, the extent to which this constitutes a real constraint may differ considerably from one case to another. In most instances the provision of technical assistance, for example, is in response to a specific request which the developing country is unlikely to be able to satisfy on the open market; compliance with such a request can hardly be regarded as a limitation of use or usefulness.[2] Much the same is true in the case of commodity transfers, the bulk of which now arise from specific requests for food which would in most cases represent a high-priority import. The principal contract between technical assistance and food transfers in the present context lies in the fact that the former was (and still remains) a drain on skills that are very scarce even in the supplying country, while the latter has its origin in active efforts on the part of supplying countries to dispose of agricultural surpluses.

What appears to be tying by source of procurement may arise in other and quite different ways. Expert advice given to a developing country—perhaps through a technical assistance arrangement—may, for example, result in import orders to certain sources without any deliberate attempt to tie the transaction on the part of the latter. The special relations which for various historical reasons link certain developing countries with particular developed market economies have similarly tended to exert a tying influence on finance and trade: because of the existing commercial and banking connexions, a loan made to such a developing country is likely to be reflected in a trade flow along traditional channels without any formal constraint. Though, with the attainment of political independence by many developing countries, there has been a general loosening of these informal restraints on the pattern of trade, some trade flows have continued to be linked to the provision of finance by particular capital exporting countries.

Efforts to measure the extent of tying as a form of constraint are thus complicated by the difficulty of determining whether it was imposed and material, or incidental and flowing merely from the way in which a regular transaction was financed.

Of principal concern in the present context has been the growth of more overt forms of tying during the past ten years, which has reduced quite significantly the flexibility of the flow of capital to the developing countries. Apart from the question of transfers-in-kind—considered in the sections that follow—the process has involved the increased use of export credits and various legislative or administrative checks on the free disposition of some of the budgetary provisions of "foreign aid". In part it has reflected the intensification of competition among the industrial countries: the more active use of credits to promote exports has served to strengthen very considerably the ties between the financial flow and the trade flow from particular developed market economies. But more recently, as a result of payments imbalances among the developed market economies, there has been a marked increase in the amount of formal contractual tying to circumscribe the use by the developing countries of the loans and grants furnished by particular developed market economies.

The recent expansion of contractual tying to help cope with balance of payments difficulties began in 1959. Following the devaluation of the franc, France wrote tying provisions into its aid agreements with the newly independent African countries. Shortly afterwards, the United States, reversing the policy on off-shore purchases that had characterized the European Recovery Programme and subsequent aid programmes, limited the use of moneys from the Development Loan Fund to procurement in the United States. In December 1960 the International Co-operation Administration (ICA) was instructed "to effect an orderly cessation of commodity procurement" in most of the developed market economies.

[2] In some cases, moreover—most notably in the technical assistance programme of the United States—personnel from a third country may sometimes be hired for the purpose.

Though purchases in the developing countries themselves were permissible, given the nature of the requirements, the use of ICA funds was confined very largely to United States' goods. Towards the end of 1962 the tying was tightened: goods of which the United States was itself a net importer could no longer be financed as foreign aid, and irrevocable letters of credit were introduced as a means of controlling procurement through cash grants. Loans from the Alliance for Progress Social Progress Trust Fund could be spent only in the member countries of the Organization of American States. The result was a rapid rise in the proportion of AID commodity expenditure effected in the United States: before 1961 it was less than half the total whereas by 1964/65 it accounted for over 90 per cent (*see* table III-2).

Table III-2. United States: Agency for International Development commodity expenditures by source of procurement, 1958/59-1964/65

Year[a]	*Total commodity expenditures*[b] *(millions of dollars)*	*Source of purchase (percentage)*		
		United States	*19 developed countries*	*Developing countries*[c]
1959	1,002	47	42	11
1960	1,040	41	49	10
1961	1,055	44	47	9
1962	884	66	16	18
1963	1,146	79	7	14
1964	1,165	87	3	10
1965	1,294	92	2	6

Source: Agency for International Development, *Operations Report, Fiscal Year 1965* (Washington, D.C.)

[a] Fiscal year ending 30 June of year stated

[b] Excluding agricultural transfers, which are effected primarily through the Food for Peace Program

[c] Off-shore procurement in countries other than the nineteen developed countries

In the United Kingdom, balance of payments stringency has also brought about a greater degree of tying. Since October 1962 direct purchases in connexion with "foreign assistance" have had to be made in the United Kingdom unless it could be demonstrated that British supplies were not available on "reasonably competitive terms". In France, formal tying provisions were introduced when the dependencies achieved statehood, and by 1964 all official contributions to these countries were tied to purchases in France or the franc zone. Partly in reaction to the restraints being imposed in other countries, the Federal Republic of Germany also tightened its tying arrangements: there was a sharp increase in the formally tied proportion of "foreign assistance" expenditures—from only 10 per cent in 1962 to over 50 per cent in 1963 and somewhat less in 1964.

The bulk of the flow of resources to the developing countries is thus subject to some form of constraint. Virtually all the transfers from the centrally planned economies are designated in kind and only a small proportion of the transfers from the developed market economies is in the form of freely disposable purchasing power. Of the commitments made by the developed market economies in 1963, for example, almost half consisted of official export credits, or loans and grants subject to contractual arrangements, one-fifth consisted of transfers-in-kind, and one-eighth of technical assistance (*see* table III-3). The tied portion was highest in countries in which official export credit was a major means of resource transfer (as in Canada, the Federal Republic of Germany, Italy and Japan), but it was also high in the United States where most loans and grants were subject to formal restriction on use. The lower proportions of tied flows among the other countries do not necessarily indicate the predominance of freely usable purchasing power: in some, technical assistance was a major form of transfer (between one-fourth and one-third in Belgium, Denmark, France and Norway, for example), and some were relieved of the need to make formal tying arrangements by the existence of particularly close institutional links with the recipient countries (as in the case of Belgium, France, Portugal, and to a less extent, the United Kingdom). Thus, even the transfers passing bilaterally in cash are not necessarily at the free disposal of the recipient countries.

THE EFFECTS OF TYING

A precise measurement of the effects of tying would require a detailed appraisal of the circumstances surrounding each transaction in both the capital exporting country and the recipient country. In general terms, however, it is clear that the tying of a cash transfer tends to reduce both its value to the recipient and its impact on the external liquidity of the source country.

Tying can reduce the value of a transfer to a developing country in two principal ways: on the one hand it tends to diminish the flexibility of the transfer and hence create possible utilization problems, and on the other hand it may involve higher costs and thus lessen the real benefit derived from a transfer of a given nominal value.

The potential loss of flexibility depends not only on the recipient country's needs and import priorities but also on the supply position in the source country and the stringency of the tying. If the latter is only a currency constraint and the source country is able to supply a wide range of goods at world market prices, the disadvantage of tying is minimal. It is also minimal if the proffered forms of transfer accord closely with the requirements of the developing country. The potential disadvantage increases as the range of available goods narrows and the competi-

Table III.-3. Developed market economies: Degree of tying of official resource transfers to developing countries,[a] 1963

(Percentage)

Country[b]	Bilateral commitments[c]				Actual net contributions to multilateral agencies[d]	Total[e]
	Tied transfers[f]	Technical assistance	Transfers in kind	Other bilateral transfers		
Japan	106	2	—	—	—8	100
Canada	89	4	1	—	6	100
Italy	55	3	3	37	2	100
Germany (Federal Republic)	53	13	—	31	4	100
United States	48	10	34	3	5	100
United Kingdom	32	15	—	44	9	100
France	26	32	—	37	5	100
Denmark	17	35	—	—	48	100
Belgium	1	23	—	57	19	100
Netherlands	—	9	—	40	51	100
Norway	—	26	—	4	70	100
Portugal	—	16	—	84	—	100
Total above	46	13	20	15	5	100

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on data from Organisation for Economic Co-operation and Development, *The Flow of Financial Resources to Less Developed Countries, 1956-1963*, and national sources.

[a] Developing countries as defined in foot-note *a* to figure I, plus Greece, Turkey and Yugoslavia.

[b] Arranged in descending order of the ratio of tied transfers to total transfers.

[c] Except in the case of France (net disbursements) and Italy (gross disbursements).

[d] As defined in foot-note *d* to figure II.

[e] Bilateral commitments plus disbursements to the multilateral agencies.

[f] Estimated on the basis of commitments in respect of official export credits and loans and grants known to be contractually tied.

tiveness of the source country diminishes. It also increases with the degree of dependence of the recipient on the source country in respect of its external purchasing power: utilization problems are likely to grow as the availability of alternatives based on free foreign exchange shrinks.

From the point of view of the supplying country, the need to tie loans and grants tends to vary inversely with its competitiveness. Thus, contractual tying poses a *prima facie* cost problem when viewed from the standpoint of the recipient. This is difficult to quantify not only because of the imperfections of the world market as a measuring base but also because the required comparisons extend far beyond the prime cost of the piece of equipment whose procurement may be tied: no less relevant are many quality and performance considerations as well as the cost of maintenance over the working life of the asset.

The fact remains, however, that original costs often do differ significantly and that tying may result in a substantial difference between the declared or nominal value of the transfer and its actual market value. A recent study in Pakistan, for example, concludes that in the early nineteen sixties the tying of foreign credits raised the average price of procurement of all foreign assistance (tied and untied) by an average of 12 per cent.[3] The difference in price between the tied source and the lowest international bid tended to be highest in the case of projects being financed as such: a comparison of a sample of twenty projects showed that tying inflated the cost by an average of about 50 per cent. These conclusions are borne out by the data on contracts put out for international bidding by the IBRD: the normal spread of prices is between 20 and 40 per cent, but on occasion the highest bid may be more than double the lowest.[4]

Assessing the effect of tying on the capital exporting country also presents difficulties. Though, as indicated above, the main reason for tying has been the desire to shield the balance of payments, it is clear that the protection obtained is only partial. Matching exports to the outflow of capital still leaves the import content of the exports uncovered. While this may be unimportant in the case of large and well-endowed countries, it is a sizable leakage in the case of many smaller industrial countries. To some extent, moreover, the finance provided by the exporting country may merely substitute for the

[3] *See* Mahbub ul Haq, "Tied Credits—A Quantitative Analysis", a paper submitted to the International Economic Association Round-table Conference on Capital Movements and Economic Development in Washington, D C, in July 1965.

[4] According to Geoffrey M. Wilson, Vice-President of the IBRD, in an address before the Economic Commission of the Council of Europe, Paris, 1963

foreign exchange which the recipient country would otherwise have used in order to acquire the goods in question. The closer the normal trade connexion between the exporting and importing countries and the higher the priority of the goods in question among the latter's requirements the greater is this substitution effect likely to be. Conversely, it cannot be assumed that what is lent or donated without a tie will all be used to finance purchases from other countries: depending again on the nature of the available goods and the closeness of the trade connexion with the recipient country, a feedback of some portion of credit is to be expected, the link being effected as a corollary to ordinary trade relations.[5]

Efforts to measure the effects of tying are also complicated by the fact that they are to some extent influenced by the state of the internal economy and the state of capacity utilization in the industries to whose benefit the procurement restraint would redound. Tying may be more necessary (if the export business is to be retained) when there is a backlog of orders and prices are rising in the capital exporting country than when firms are more actively seeking new business in the international market.

[5] For a detailed discussion of the problem of measuring the substitution and feedback effects, *see* Walter S. Salant and Associates, *The United States Balance of Payments in 1968* (Brookings Institution, Washington, D.C., 1963); Alan M. Strout, "Foreign Aid and United States Exports: a Statistical Analysis" (mimeographed, Washington, D.C., 1964), and Richard Cooper, "Foreign Assistance and the Balance of Payments of Donor Nations" in United Nations, *Proceedings of the United Nations Conference on Trade and Development, Volume V, Financing and Invisibles, Institutional Arrangements* (Sales No.: 64.II.B.15).

In order to appraise the cost of "untying" it is instructive to examine the estimates that have been made of the two main quantitative effects cited above for the principal country now practising contractual tying. Estimates based on a study of the United States balance of payments[6] indicate that on a broad regional basis the substitution effect ranges from 30 per cent in the case of Africa (where trading links are relatively weak and the chance of displacing commercial exports by AID loans and grants is correspondingly low) to 50 per cent in the case of Latin America where ordinary trade relations are much closer. Similarly, the proportion of an untied outflow likely to be spent in the United States is estimated to range from 15 per cent in the case of Africa to 55 per cent in the case of Latin America. Applying these coefficients to the pattern of AID commodity expenditures in 1963/64, it is seen that loans and grants totalling $1,134 million would probably have resulted in a foreign exchange outflow of about $725 million if no restraints had been imposed on the use of the funds, as against a loss of about $272 million with procurement tied to the United States. The net balance of payments effect of the tying was likely to be weakest (less than one-fourth of the AID expenditures) in the case of Latin America. On the basis of assumptions made, tying would save about 45 per cent of the funds made available to the Near East and South Asia and almost 60 per cent of those provided to Africa (*see* table III-4).

[6] *See* the study by Walter S. Salant and Associates referred to in the previous foot-note.

Table III-4. United States: Estimated effect of tying on the balance of payments, fiscal year 1964

(Millions of dollars, except as indicated)

Region	(1) AID commodity expenditures	(2) Substitution coefficient (percentage)	(3) United States commercial exports displaced (1)x(2)	(4) Feedback coefficient (percentage)	(5) Reflow into United States of displaced exports (3)x(4)	(6) Outflow resulting from tied assistance (3)−(5)	(7) Outflow resulting from untied assistance (1)−((1)x(4))	(8) Net balance of payments effect of tying: Amount (7)−(6)	(9) Net balance of payments effect of tying: Percentage (8)÷(1)
Near East and South Asia[a]	684.0	35	239.4	31	74.2	165.2	472.0	306.8	45
Far East[b]	286.8	45	129.1	47	60.7	68.4	152.0	83.6	29
Latin America[c]	93.4	50	46.7	55	25.7	21.0	42.0	21.0	23
Africa[d]	69.8	30	20.9	15	3.1	17.8	59.3	41.5	59
Total	1,134.0[e]		436.1		163.7	272.4	725.3	452.9	40

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat based on Operations Reports of the Agency for International Development, and Walter S. Salant and Associates, *The United States Balance of Payments in 1968* (Brookings Institution, 1963).

Note: The substitution coefficient is the amount of United States commercial exports displaced by one unit of tied AID outflow. The feedback coefficient is the amount which will eventually be spent in the United States per unit of untied AID outflow. The figures for the substitution and feedback coefficients used here are from the Brookings Institution study cited in the source. These coefficients are derived from a 1960 matrix of the trade between the United States and the different regions.

[a] Aden, Afghanistan, Ceylon, Cyprus, Greece, Jordan, India, Iran, Iraq, Israel, Kuwait, Lebanon, Pakistan, Saudi Arabia, Syria, Turkey, United Arab Republic, Yemen and Persian Gulf sheikdoms.

[b] Burma, Brunei, Cambodia, China (Taiwan), Hong Kong, Indonesia, Laos, Macao, Malaysia, Philippines, Republic of Korea, Ryukyu Islands, Sabah, Singapore and Thailand.

[c] Twenty republics and the Caribbean area.

[d] Continental Africa and associated islands, excluding South Africa and United Arab Republic.

[e] This figure differs slightly from the total shown in table III-2 which includes expenditures on commodities not shipped to the regions indicated.

This rough calculation may well overstate the foreign exchange saving effect of United States' tying practices. Being based on a total trade matrix, the feedback coefficients are probably lower than they would be if the trade in development goods alone was taken into account; for in the case of such goods it is probable that the United States has some competitive advantage as a source of supply.[7] And the coefficients that have been used, being regional averages, are probably lower than those applicable to the countries receiving AID loans or grants, which may well have closer trade links with the United States. On the other hand, where tying is used to foster a pattern of exports different from that reflecting the import requirements of the developing countries concerned, the substitution coefficients would be lower, regular commercial exports less affected and the exchange-saving impact of tying so much the greater. Some allowance should also be made for the longer-run effect of the process: in so far as tying serves to introduce goods into new markets or to install equipment which may be expected to generate a future demand for spare parts and replacements it may be more beneficial to the capital exporting country's balance of payments than the immediate impact would indicate.

[7] This is borne out by the relatively high proportion of purchases made in the United States in connexion with earlier, untied "foreign aid" expenditures—by the ICA for example—and also by the relatively high proportion of IBRD loans, also untied, which are in fact used for procurement in the United States.

Proposals for untying

The argument against tying lies partly in its harmful effects on the developing countries seeking to utilize their external resources to the greatest advantage and partly in the fact that as far as the more advanced countries are concerned it is a good deal less efficacious than it seems. But the strongest argument is implicit in the fact that the payments problems of the more advanced countries which have given rise to the tying of "aid" stem from disequilibrium among themselves and not out of their balance with the developing countries. An increase in the flow of financial resources from the former to the latter is likely to be followed promptly by a corresponding increase in the demand for goods and services from the more advanced countries as a group. This suggests that in order to minimize the effect on these countries of the untying of their loans and grants to the developing countries, the operation should be carried out simultaneously and universally.

To minimize the impact is not to eliminate it, however: because of the existing pattern of bilateral flows and the existing commercial links between certain of the developing countries and particular developed market economies there would probably be a number of losses and gains among the latter. In the case of the United States for example—which, because of the relative magnitude of its bilateral outflow would probably stand to lose most by the freeing of cash transfers—the impact of untying might well be reduced from the 40 per cent that unilateral action would entail to between 20 and 30 per cent if other developed market economies participated in a joint action.[8]

While it is thus clear that the process of untying calls for a multilateral approach, it is equally evident that the complexity of both concept and practice rules out any simple proscription of one or other of the formal constraints that may be imposed on the use of funds. What seems to be required is a series of concerted measures all aimed at the same objective, namely, to reduce the impact of the various forms of constraint in the two respects in which they are potentially inimical to the developing countries—rigidity and cost. The acceptability and effectiveness of such measures, however, hinge very largely on the success achieved by the capital exporting countries in lessening the disequilibria among themselves which lie at the root of many of the defensive actions affecting their dealings with the developing countries.

Perhaps the simplest move towards untying would be an increase in the use of the international institutions for effecting resource transfers to the developing countries. Though the institutions are not completely immune from the restraints implicit in tying, and some of them accept contributions in inconvertible currencies or with other limitations on use, yet on the whole their procedures are generally such as to reduce the over-all incidence of the constraints placed on contributions.

A multilateralizing effect may also be obtained through a system of regular confrontation of the parties concerned, such as has been achieved through so-called aid consortia and consultative groups.

[8] Based on estimates similar to those involved in table III-4, assuming (*a*) that the untying of $1 billion by the United States is matched by the untying of between $1 and $2 billion by other developed market economies combined; (*b*) that the regional distribution of the flows is not changed by the untying, and (*c*) that the feedback and substitution coefficients applicable to the other developed market economies are more or less complementary to those for the United States.

Within a mechanism of this type the needs of the developing country are expounded before a number of potential providers of external finance; the resource flow is, in principle, made more fluid, choices before the developing country are enlarged and the chances of its being penalized by serious discrepancies in cost are reduced.

Any arrangement which would facilitate international competitive bidding on capital projects would lessen one of the risks of tying. The IBRD is able to base its own disbursements on such competition, and a technical costing service (even without the subsequent financing) would meet a need that arises very frequently in the development process. The ability to establish a bench-mark through the work of consulting engineers and quantity surveyors placed at the disposal of a developing country by an international project-costing service would go a long way towards ensuring that tied financing was not associated with unduly onerous terms. Such a service would fill a gap in the range of multilateral assistance which now extends from pre-investment surveys and general feasibility studies to the actual financing. Even if the financing were done bilaterally and procurement tied to the country that was providing the capital, the international survey and costing arrangements could serve as a control.

Untying need not be a single once-and-for-all action. It might be achieved piecemeal by the progressive extension of a waiver system, for example, which permitted an increasing proportion of the amount being transferred to be used for procurement in markets of the recipient's choosing. Whether tying provisions could be loosened by allowing the capital exporting country to designate other markets that might be used is less clear. To some degree this has been done by the United States in permitting AID grants to be spent in developing countries, but an extension of the process of geographical waivers of tying provisions—to countries that have close trade relations, and hence high feedback ratios, with the capital exporters, for example—might be regarded as potentially discriminatory.

Liberalization of tying practices depends ultimately on the lessening of the need for defensive action on the part of the country that is making resources available to the developing countries. This requires the mitigation of the imbalances that exist among the developed market economies themselves. While this is being achieved, improvements will have to come from the efforts of individual countries to gear their policies and procedures as closely as possible to the development needs of the recipient countries, freeing their transfers as far as possible in order to minimize utilization problems and maximize effectiveness. In this process the use of the international institutions can play an important part, while agreement is sought on multilateral liberalization

The transfer of resources in kind

The transfer of resources in kind has always been an element in the external financing of development: it is often an essential part of the process of direct investment and it played a key role in the rehabilitation operation of UNRRA and the ERP and in relief activities under those programmes and under UNICEF and other United Nations agencies. In the middle of the nineteen fifties, however, it took on a new dimension: the ending of the phase of post-war reconstruction brought about a significant change in the pattern of production and trade and left North America with an over-expanded agricultural capacity. At the same time, an agricultural lag began to make itself felt in several of the developing countries, under the impact of urbanization and the increased industrial intake of raw materials as well as an upward movement in population growth rates and a keener awareness of the inadequacy of existing nutritional levels.

With the passage of the Agricultural Trade Development Act of 1954 (United States Public Law 480), the scene was set for a major expansion in the transfer of resources in kind to the developing countries. Dominated in the early years by the anxiety of the United States (and to a much less extent, Australia, Canada and France) to dispose of "surpluses" generated largely by agricultural support programmes, this transfer came increasingly under the influence of the needs of many developing countries. Though characterized chiefly by their low level of industrialization, the developing countries as a group became large-scale importers of primary agricultural products: by the end of the nineteen fifties their combined imports of food-stuffs totalled about $3 billion a year, and their imports of grain alone over ten million tons. And in the first four years of the nineteen sixties these commodity transfers—overwhelmingly of food and very largely of wheat—accounted for about one-fourth of all official bilateral loans and grants made by the developed market economies to the developing countries.

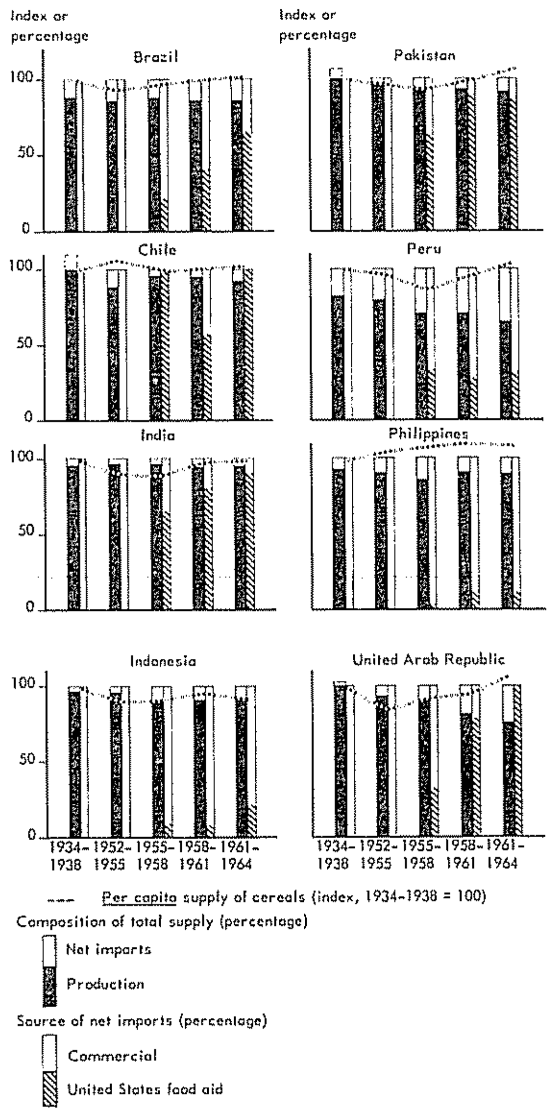
This massive transfer of resources is now the object of critical reappraisal growing out of changes on both the export side and the import side. On the one hand the pressure to get rid of surpluses has greatly diminished, and on the other hand doubts about the wisdom of continued dependence on food imports and its impact on domestic production and development have emerged more clearly. The situation is reflected in General Assembly resolution 2096 (XX) which calls for a thorough review of world food strategy. This review is to be made jointly by the United Nations and the Food and Agriculture Organization during the next two years. Its conclusions cannot be anticipated, but the essence of the problem needs to be outlined if the role in development finance of commodity transfers in general and "food aid" in particular is to be appreciated.

The problem on the supply side can be stated very simply. Under the influence of the continued growth in shipments to the developing countries and recent calls on the world market by mainland China and the Soviet Union, stocks have been drawn down. In mid-1965 total grain stocks in the four leading exporting countries—Argentina, Australia, Canada and the United States—were at their lowest level in ten years. In the case of wheat, the principal crop concerned, stocks, which had increased from about 20 per cent of one year's production in 1952 to nearly 90 per cent in 1960, had dropped back below 60 per cent by 1964. At the same time, certain changes have been instituted in the systems of price and income support, making them less conducive to an expansion in output. As further changes of this nature are pending, there is an urgent need to decide on the role that the major food exporters —chiefly developed market economies—are likely to be required to play in relation to global needs as well as in their domestic market.

On the side of the developing countries the problem is a much more complex one because of the number of unknown and uncontrollable elements in it. Its essential nature, however, may also be stated simply. In a number of developing countries, including several with large absolute levels of demand, dependence on imports will almost certainly increase in the period immediately ahead: these countries are experiencing an acceleration in population growth and their *per capita* levels of supply of basic cereals have barely maintained the relatively low pre-war figures (*see* figure VIII). It would seem to be virtually impossible suddenly to reverse the trend towards greater dependence on imports—and in particular on non-commercial imports—that has characterized these countries in recent years.

And yet, in the longer run, this trend has to be reversed if these countries are to achieve a satisfactory rate of economic growth. This is not a question of seeking agricultural self-sufficiency as a goal but of the necessity to raise productivity in a sector

Figure VIII. Selected food deficit countries: *Per capita* cereal supply, the share of net imports in total supply, and the share of United States aid in net imports,[a] annual average, 1934-1938 to 1961-1964



Source: United Nations, *Demographic Yearbook, 1964* (Sales No.: 65.XIII.1); Food and Agriculture Organization of the United Nations, *Production Yearbook*, *Trade Yearbook* and *World Grain Trade Statistics* (Rome); United States Department of Agriculture, *United States Grain Exports under Government Programs* and *The 1964 Far East, Communist China, Oceania Agricultural Situation* (Washington, D.C.).

[a] Cereals include wheat, rye, barley, oats, maize, millet, sorghum (grain), plus rice (unmilled equivalent) and flour (as grain equivalent).

that still accounts for the bulk of total output in the countries concerned. The problem is a dual one: to push ahead as rapidly as possible with agricultural development, and to use external supplies of food and other commodities to assist in the process or at least in a way that does not serve to detract from the domestic effort.

In the present context it is not the vast problem of agricultural development that is at issue but rather that of deploying commodity transfers to the greatest advantage. On the negative side it is clear that the availability of such supplies should not be allowed to breed complacency regarding the food situation as a whole, or to discourage local production through the impact on the market in general or on grain prices in particular. (There is evidence that both these effects have actually been experienced from time to time.) On the positive side, a good deal of experimentation has taken place in recent years on ways and means of using such transfers to facilitate capital formation and to raise the general level of nutrition and productivity, not least through greater output of domestic agriculture.

These experiments, while often successful and always instructive,[9] have tended to emphasize the difficulties that arise from the fact that the exercise has continued to be primarily one of surplus disposal. Except to a modest extent within the framework of the World Food Programme—which has specifically sought contributions of a variety of commodities and also, significantly, of cash—the transfers have been of products in excess in the source country, not of products in short supply in the recipient country. This has made it extremely difficult to raise the quality of the diet, and even in the provision of the staple, wheat has sometimes had to be substituted for rice.

On the other hand, where the need for additional grain supplies was urgent—following a poor harvest, for example—the availability of food aid lightened the burden on foreign exchange, which would otherwise have had to be used to finance commercial imports; and the exchange saved could then be used to maintain the level of developmental imports. To the extent that regular commercial imports have been replaced in this process there has been an obverse side to this gain by the aid recipient. Actually, total imports of wheat into the developing countries in the quinquennium ending in 1963/64 were over double those in the corresponding period ending in 1953/54, but commercial imports were 10 per cent lower. This implied loss probably fell mainly on the grain exporters among the more advanced countries. More serious from the point of view of the developing countries has been the stagnation in rice imports. In the aggregate, rice imports into the principal deficit countries—Ceylon, India, Indonesia and Pakistan—in the nineteen sixties have been at much the same rate as in the nineteen thirties: the great upsurge in cereal imports has been almost entirely in wheat.

If grain "surpluses" are about to disappear, a notable chapter in the history of international economic relations will have come to an end. The imaginative use of these surpluses epitomizes the change that has taken place—both in attitudes and in the capacity to manage—since the dismal days of stock destruction in the nineteen thirties. While the disappearance of surpluses will represent an improvement in the balance of market forces, it will pose a major challenge in respect of both "aid" policies and world food policies. The ending of food transfers would cause not only a considerable reduction in the total flow of resources to the developing countries but also a critical situation in the food deficit countries previously in receipt of large tonnages of non-commercial imports.

Such a challenge also represents a signal opportunity for the gradual replacement of commodity transfers by cash transfers. In so far as food constitutes a high-priority import, and the countries that have generated surpluses are those with the capacity for rapidly increasing production, the transition to cash transfers would not occasion any drastic immediate realignment in the flow of real resources. It would, however, open up the possibility of several desirable changes. It would permit some redistribution of the burden among the capital exporting countries and it would enable the developing countries concerned to make more rational decisions about resource allocation—to the advantage of domestic agriculture and of consumers' needs and preferences, which would in turn benefit some of the other developing countries from which commercial imports might then be expanded. The increase in flexibility would thus improve the quality of international development finance, and it would be in the interest of internal development strategy (in which agriculture needs to be given its due place) as well as of international policies relating to the supply of food (in which some developing countries should emerge as larger net contributors).

To cite these potential gains is to open up the vast array of questions implicit in General Assembly resolution 2096 (XX). For just as the emergence of surpluses in the nineteen fifties reflected policies not only in the countries in which they were physically accumulated but also in the countries in which they might have been marketed had agricultural trade been freer, so the possible vanishing of surpluses in

[9] They include efforts to harness underemployed workers to labour-intensive development projects, the use of grain to establish dairy and poultry industries, the feeding of school children and indigents, and other extra-market uses calculated to raise human productivity without affecting ordinary local demand for food.

the nineteen seventies raises questions of future agricultural policies in all countries—net importers among the more advanced countries as well as net exporters, and the developing countries with food surpluses as well as those with food deficits. Though the problems posed in the present context concern the transfer of food as a means of financing development, what is really at issue is global food policy.

The role of technical assistance

Though the provision of technical assistance is a form of transfer-in-kind it is subject to rather different considerations from those governing the commodity transfers discussed in the previous section. What the developing country usually requires tends to fall into two categories: on the one hand is the need to make good the local deficiency in particular strategic skills, and on the other is the need for advice or instruction of a highly specialized nature and in most cases for a relatively short period. To some extent such skills and expertise are components of the direct investment package, and the need for special arrangements for their provision in a particular country is inversely related to the availability and importance of direct foreign investment. But the need often extends far beyond the range of operations ordinarily associated with private enterprise: it is often greatest in the area of public administration and in connexion with the many social and economic activities for which the government has responsibility.

Both the nature and the duration of the need tend to make it extremely difficult to satisfy on the market. While for many purposes consultants can be hired on a commercial basis, the type of expertise and the scale of requirements are such that the developing countries cannot always rely on the market mechanism to obtain the right kind of assistance at the right time. Thus, whatever the merit of providing resources in the most flexible form, cash would in most cases be a poor substitute for technical assistance. It is only through the organizing efforts of the more advanced countries and the multilateral agencies that appropriate skills can be mobilized and placed at the disposal of the developing countries.

The magnitude of the effort involved is indicated by the fact that the various programmes—bilateral and multilateral—of the developed market economies in the nineteen sixties have provided the developing countries with about 100,000 man-years of technical assistance each year. The great bulk of this has been made available to countries in Africa, where the skill shortage is generally most acute (*see* table III-5). Apart from the broad instructional purpose of the whole exercise, most of the persons involved have been formally engaged in education, chiefly as teachers, especially in the case of North Africa where the schools have continued to rely heavily on staff from France. A sizable proportion of the assistance has been in government service as such; this has been particularly so in central Africa where the lack of trained cadres has been a serious handicap to efficient public administration in many of the newly independent states. A certain amount of expert help has also been publicly provided for solving problems in industry and agriculture, sectors in which, in most of the developing countries, the bulk of external assistance has been organized privately.

The multilateral technical assistance programme, though very much smaller, has a somewhat wider and more uniform geographical spread than the bilateral programmes, though here too there has been a certain concentration on Africa in recent years (*see* table III-6). The functional spread of the multilateral programme has also been wider: school teaching as such has been only a minor feature; relatively more expertise has been marshalled in the field of health and sanitation and, also in an attempt to solve problems in the more immediately productive sectors, in agriculture, manufacturing and resource surveys.

The over-all technical assistance effort is difficult to measure, even in the crude terms of man-years of expert service. For aside from the large amount of privately organized assistance referred to above—much of it as an integral part of direct investment—most other resource transfers are accompanied by what, if separately arranged, would be classified as technical assistance. A large amount of such expertise is necessarily involved in almost every financial transfer: the appraisal and supervision of projects for which loans and grants are made, for example, embody a large element of what would in other circumstances be regarded as technical assistance. Indeed, in many cases, such assistance is an essential prerequisite to any negotiation for external finance.

This serves to emphasize the main relevance of technical assistance in the present context: it should serve to increase the ability of the recipient country to make effective use of other resources, including those that are externally provided. By expanding the supply of complementary factors and improving their quality, it should help to raise the capacity of developing countries to absorb capital from abroad for productive deployment.

The contribution that technical assistance makes to the financing of economic development depends

Table III-5. Developed market economies: Provision of bilateral technical assistance, by recipient area and by type,[a] 1963

(Percentage, except as indicated)

Region	Total number of experts (thousands)	Regional distribution	Distribution by type: Teachers	Other education	Public administration	Agriculture	Industry	Health and sanitation	Other, and unclassified
Total	78	100	48	3	17	7	11	5	8
Europe	1	1	61	6	5	7	7	3	12
Africa	65	84	50	2	18	7	11	5	6
North of Sahara	35	45	66	3	13	3	9	4	2
South of Sahara	30	39	32	1	25	11	13	6	11
America	3	4	37	8	11	10	12	6	16
Central	1	1	34	7	15	10	13	11	11
South	2	2	39	9	9	11	10	4	18
Asia	8	10	39	4	10	7	13	7	19
West	1	2	34	8	14	10	16	9	9
South	2	2	34	3	4	10	14	5	30
Far East	5	6	43	4	11	6	12	7	18
Oceania	1	1	8	—	44	12	23	8	5
Not classified	—	—	—	—	—	1	—	—	99

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on Organisation for Economic Co-operation and Development, Development Centre Studies, No. 3, *The Use of Foreign Training and Skills in Developing Economies*, by Angus Maddison (Paris, December 1964).

[a] Financed by members of the OECD.

largely on three distinct but related factors—the choice of problem or deficiency, the actual operation and the subsequent follow-through. It is also influenced by the fact that either because of the nature of the question asked or the task set or because of the nature of the available supply of personnel, technical assistance is essentially a short-term exercise geared to longer-term needs. In each of these areas experience has shown that serious difficulties can arise.

The usefulness of technical assistance as an adjunct to development finance depends on its being addressed not only to the right problem but also at the right time in relation to the sequence of other needs and events. This requires some rational determination of priorities, if not in the framework of a more or less articulated development plan then at least in accord with a broad development strategy, the pursuit of which requires, *inter alia*, the elimination of recognized bottle-necks. (In many developing countries even the recognition of bottle-necks may require technical assistance, and the elaboration of development plans and programmes is itself a major area of need.) To say that it is to help solve these bottle-neck problems that the technical assistance priorities ought to be assigned may sound unnecessarily trite but, as indicated above, appropriate expertise is one of the scarcest of the resources to be transferred from the more advanced economies to the developing countries, and the short history of this international effort is replete with examples of priorities being set by the availabilities in the source country or at the disposal of the administering agency.

The scarcity of the relevant expertise is one of the principal difficulties to become apparent when technical assistance is in action. For here success depends largely on the quality of the "expert", and requirements are formidable indeed. What is needed is not only a high level of competence of a purely professional nature but also an adequate endowment of the combination of knowledge and imagination necessary to solve the technical problems in the unique indigenous setting of the developing country concerned. This may involve not only physical differences (in soil and climate, for example) and economic differences (in factor availabilities, costs and markets) but also more subtle differences in attitudes and institutions which may often call for a solution differing significantly from that flowing from technical considerations alone.

But even the work of the best endowed expert may be aborted if receiving conditions are not suitable. The key element is often the arrangement for a local counterpart charged with learning from the expert during the relatively short period he is on the job and equipping himself to perform the function in question or to assist in implementing the recommendations of the mission when it is over. The whole operation is thus a highly personal one and the relationships involved are often very delicate. They are almost inevitably complicated by the fact that standards of remuneration applicable to a temporary expatriate who has been persuaded to interrupt his career in order to undertake the mission in question are likely to differ considerably from those of his local counterpart and of other local personnel with whom he has to work and associate.

Table III-6. Technical assistance: Experts and fellowships financed under the United Nations Expanded and Regular Programmes, by region, 1964

Region	Number of experts sponsored by										Experts		Fellowships	
	UNTA	ILO	FAO	UNESCO	ICAO	WHO	UPU	ITU	WMO	IAEA	Number	Percentage	Number	Percentage
Europe	96	23	19	24	—	85	—	—	6	42	295	5	1,691	20
Africa	498	189	325	412	42	444	5	31	44	30	2,020	36	2,370	28
North of Sahara	80	53	56	63	8	75	1	3	5	16	360	6	557	7
South of Sahara	275	120	231	294	28	322	4	24	27	14	1,339	24	1,806	22
Regional	143	16	38	55	6	47	—	4	12	—	321	6	7	—
America	316	104	186	183	38	149	3	11	9	36	1,035	19	1,555	19
North and Central	91	38	62	55	11	57	—	4	5	6	329	6	719	9
South	140	47	98	82	19	62	2	5	3	28	486	9	836	10
Regional	85	19	26	46	8	30	1	2	1	2	220	4	—	—
Asia[a]	399	142	232	282	47	548	—	19	41	73	1,783	32	2,652	32
Middle East	112	48	62	87	19	113	—	6	16	23	486	9	701	8
South	96	40	91	82	15	205	—	6	3	11	549	10	793	10
Far East[a]	191	54	79	113	13	230	—	7	22	39	748	13	1,158	14
Oceania[b]	6	—	3	2	—	11	—	—	—	—	22	—	60	1
Interregional	188	10	22	—	17	124	2	—	1	—	364	7	1	—
Grand total	1,503	468	787	903	144	1,361	10	61	101	181	5,519	100	8,329	100

Source: United Nations, *Official Records of the Economic and Social Council, Thirty-ninth Session, Supplement No. 5* (*Annual Report of the Technical Assistance Board to the Technical Assistance Committee for 1964*, annexes).

[a] The figures for Asia and the Far East include six experts and 103 fellowships supplied to Japan.

[b] The figures for Oceania include twenty-three fellowships awarded to Australia and New Zealand.

This disparity, with all its ensuing difficulties, lies behind attempts to organize more modest forms of technical assistance such as the United States "Peace Corps" and the European "Volunteers for Development". The number of these amateurs now in the field is approaching 20,000, and the experiment is advanced enough to show that this effort is another complementary one. It does not in general dispose of the expertise commonly sought in the technical assistance expert. On the other hand, the volunteer is often better qualified for closer and lengthier contacts with development personnel at the working level—district and village administrators, teachers, agricultural extension officers and so on—than is the ordinary run of professional technical assistance expert.

Evidence appears to be accumulating that some filling in of the middle ranges of the spectrum is now required: efforts are needed on the one hand to raise the technical competence of the volunteer and on the other to develop the so-called "opex" (operation executive) concept so as to allow a higher proportion of the technical assistance experts to become more closely integrated with the regular administration in developing countries. This seems particularly desirable in the economic field, for the older traditions of public administration have not always proved conducive to the emergence of appropriately trained officials, not only to staff a planning office as such but also to raise the capacity of the regular ministries to participate in plan formulation and implementation.

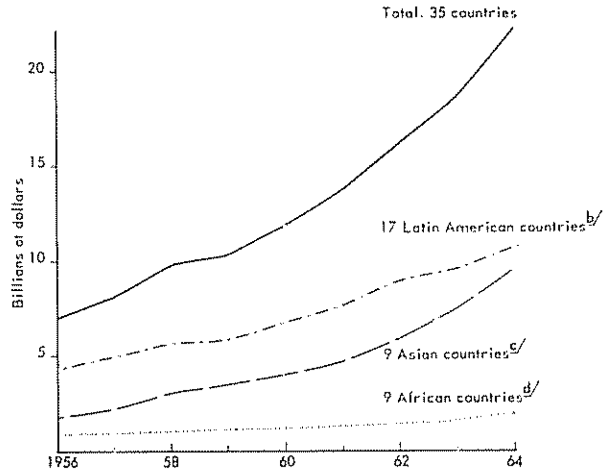
The problem of external debt

Though the external debt of the developing countries is not comprehensively documented, sufficient is known about it to show that in the aggregate it is now very large both by historical standards and in relation to debt-servicing capacity. In 1964 the total had reached the order of $40 billion (substantially more than that year's export earnings) and the outflow of interest and amortization payments was about $5 billion (well over half the net inflow of new long-term capital and donations).

About three-fourths of this debt was owed or guaranteed by governments. Between 1956 and 1964 this public-guaranteed debt had grown at about 15 per cent a year (*see* figure IX); in the nineteen sixties the rate of growth has been somewhat higher, reflecting the switch of some of the United States transfers from grants to long-term loans. Between 1956 and 1964 the average rate of increase in service payments was about 17 per cent a year (*see* figure X); this has tended to decelerate slightly since 1963, however, reflecting a certain easing of the terms of lending.

The growth of external public-guaranteed debt in the past ten years is not explicable in common terms; though there are some general patterns, in the precise phasing of the borrowing process and in detailed terms of the loans each developing country seems to have followed its own distinct course. Some countries started the period with a large official debt and further borrowing has constituted only small relative increases. Others began to borrow only later and have since registered extremely high rates of annual increase. In some the borrowing has been mainly of a long-term developmental nature; in others there has been a good deal of relatively short-term borrowing for more or less commercial purposes.

Figure IX. Developing countries: Growth of external public-guaranteed debt,[a] 1956-1964



Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Proceedings of the Conference on Trade and Development, Volume V, Financing and Invisibles, Institutional Arrangements*, and International Bank for Reconstruction and Development.

[a] Based on data from thirty-five countries; preliminary in the case of 1963 and 1964. Debt service refers to interest and amortization payments in respect of the public-guaranteed debt.

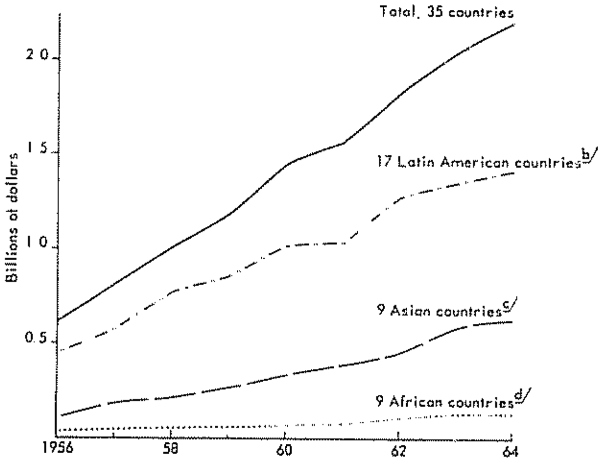
[b] Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

[c] Burma, Ceylon, Federation of Malaya, India, Iran, Israel, Pakistan, Philippines and Thailand.

[d] Ethiopia, Nigeria and Sudan; Kenya, Tanzania and Uganda (and East African Common Services Organization), and the former Federation of Rhodesia and Nyasaland (Malawi, Rhodesia and Zambia).

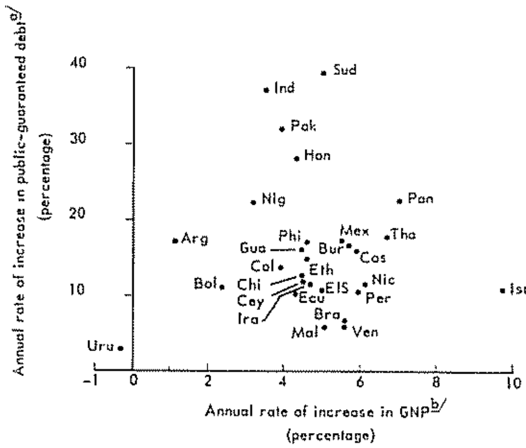
Given this great diversity in nature, magnitude, timing and purpose, there has been no discernible tendency for borrowing to be related to the rate of growth in production (*see* figure XI). A few of the

Figure X. Developing countries: Growth of external debt service,[a] by region, 1956-1964



Source and foot-notes as for figure IX.

Figure XI. Developing countries: Growth of gross national product and public-guaranteed debt,[a] 1956-1964



Arg	Argentina	Ira	Iran
Bol	Bolivia	Isr	Israel
Bra	Brazil	Mal	Malaysia
Bur	Burma	Mex	Mexico
Cey	Ceylon	Nic	Nicaragua
Chi	Chile	Nig	Nigeria
Col	Colombia	Pak	Pakistan
Cos	Costa Rica	Pan	Panama
Ecu	Ecuador	Per	Peru
ElS	El Salvador	Phi	Philippines
Eth	Ethiopia	Sud	Sudan
Gua	Guatemala	Tha	Thailand
Hon	Honduras	Uru	Uruguay
Ind	India	Ven	Venezuela

Sudan (1956-1962), Ethiopia (1958-1963) and Iran (1956- and Policies of the United Nations Secretariat, based on data from the Statistical Office of the United Nations, International Monetary Fund, International Bank for Reconstruction and Development and Organisation for Economic Co-operation and Development.

[a] 1955-1964, except for Bolivia, Brazil and Iran (1955-1963) and Guatemala and Uruguay (1955-1962); average annual compound rate of increase between terminal years

[b] At 1960 prices; 1956-1963, except for Costa Rica, Federation of Malaya, Honduras, India, Nigeria, Panama, Sudan (1956-1962), Ethiopia (1958-1963) and Iran (1956-1961): average annual compound rate of increase between terminal years

more rapidly growing countries increased their public-guaranteed debt at less than the average rate, most notably Brazil, the Federation of Malaya, Israel, Nicaragua, Peru and Venezuela. But there were also some rapidly growing countries—Mexico, Panama, Sudan and Thailand, for example—which increased their public-guaranteed debt at more than average rates. Similarly, among the slower-growing countries there were some that were under-average public borrowers (Bolivia, Ceylon, Chile, Colombia and Ecuador, for example) and others whose public-guaranteed debt rose at over-average rates (Argentina, Honduras, India, Nigeria and Pakistan, for example).

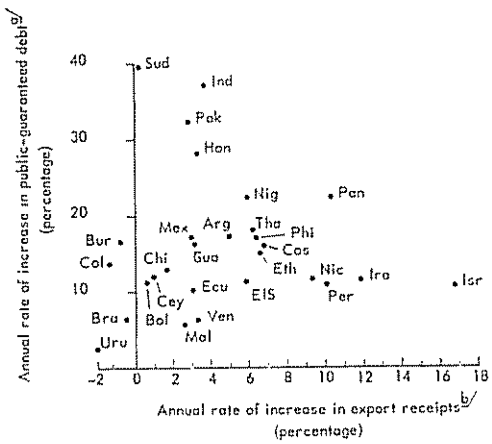
In general, governments borrow from abroad chiefly to meet the foreign exchange costs of their own investment decisions. To some extent, such borrowing is resorted to if other forms of resource transfer are not available or are inadequate for the immediate purpose. Among these other transfers is private credit, and government obligations may also be increased by guarantees given in respect of such credit, which may move with ordinary commercial imports rather than with specific capital projects.

The various forms of transfer are not necessarily substitutes for one another. Sometimes there may even be a complementary relationship: when, for example, an influx of direct investment makes more urgent the need for infra-structure and other forms of public capital formation, and thus stimulates government borrowing from abroad. In a developing country, moreover, the relationship between capital formation and output often tends to be erratic over short periods and, in so far as public borrowing may often be for purposes that do not yield an immediate increment in measurable production, the absence of any systematic link between the rise in indebtedness and the growth in output is not unexpected.

Nor, by the same token, is it surprising that public borrowing during the period under review does not seem to have been related to export volume and still less to export proceeds, which in the case of most developing countries are subject to major and often sudden price changes on the world market. Over-average rates of increase in debt accumulation were associated as often with low rates of growth in export receipts (Burma, Honduras, India, Pakistan and Sudan) as with relatively high rates of growth (Costa Rica, Nigeria, Panama, Philippines, Thailand). Correspondingly, among the countries whose official debt grew at less than average rate there were as many countries with high rates of increase in export receipts (El Salvador, Iran, Israel, Nicaragua, Peru) as there were with relatively low rates of export increase (Bolivia, Brazil, Ceylon, Federation of Malaya, Uruguay). (*See* figure XII.)

The implications of this are more serious when viewed from the obverse side: the rise in the debt-servicing burden has not always been accompanied by a commensurate expansion in export earnings. And in the period 1956-1964 there were many countries in which service payments rose faster than the

Figure XII. Developing countries: Growth of export receipts and public-guaranteed debt, 1956-1964



Arg	Argentina	Ira	Iran
Bol	Bolivia	Isr	Israel
Bra	Brazil	Mal	Malaysia
Bur	Burma	Mex	Mexico
Cey	Ceylon	Nic	Nicaragua
Chi	Chile	Nig	Nigeria
Col	Colombia	Pak	Pakistan
Cos	Costa Rica	Pan	Panama
Ecu	Ecuador	Per	Peru
ElS	El Salvador	Phi	Philippines
Eth	Ethiopia	Sud	Sudan
Gua	Guatemala	Tha	Thailand
Hon	Honduras	Uru	Uruguay
Ind	India	Ven	Venezuela

Source and foot-notes as for figure XI.

average but in which export earnings rose at well below average rates—Bolivia, Burma, Ecuador, Guatemala, Honduras, India, Mexico, Sudan and Venezuela, for example (*see* table A.III-1 in the annex to this chapter).

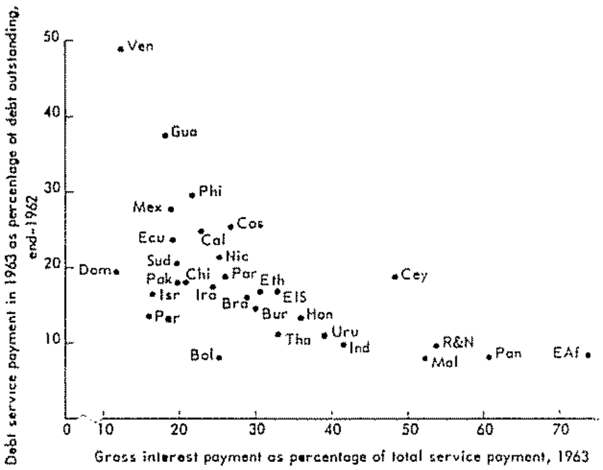
This is not to imply that the ratio of debt service payments to export earnings is the only or the best indicator of a country's capacity to carry additional external debt. Among the countries in which this ratio is extremely high are not only Argentina, Brazil and Chile, whose debt burden has already precipitated several balance of payments crises, but also Israel and Mexico, whose growth and stability have earned for them a high credit standing which has enabled them to raise capital on the international bond market.

In 1964, for the developing countries as a group, service payments on public-guaranteed debt absorbed about 10 per cent of total export earnings. This ratio had been rising rapidly as, over the preceding eight years, such debt service had increased more than three times as fast as had exports. While for individual countries there may be marked differences in the course of service payments—reflecting the wide variations in the age structure and terms of the debt—for the developing countries as a whole the burden of debt service is likely to rise even more sharply in future as grace periods come to an end and interest and amortization have to be paid on the debt contracted in the nineteen sixties.

The wide differences in debt structure may be illustrated from the data on amounts outstanding in 1962. The proportion repayable within the next quinquennium ranged from less than one-fifth in the case of East Africa (Kenya, Tanzania, Uganda and the Common Services Organization combined), the Federation of Malaya, Panama and Rhodesia and Nyasaland to over half in the case of Guatemala, Iran, Israel, Mexico, Philippines and Venezuela (*see* figure XIII). In the former group, with a high proportion of newly contracted long-term obligations, over half of annual service payments were on account of interest, and the total constituted less than 10 per cent of the amount outstanding. In the latter group, with a high proportion of old, maturing obligations and some newer and shorter-term debt, less than one-fourth of annual service payments were for interest and over three-fourths for repayment of principal, while the total service charge was a much higher proportion of the outstanding debt—almost one-fifth in the case of Iran and Israel, around one-third in Guatemala, Mexico and the Philippines, and almost half in the case of Venezuela (*see* figure XIV).

The structure of the debt obviously has implications for the future service charge burden. This may be illustrated by reference to the growth of the external public-guaranteed debt in India. The external financing of the first five-year plan was effected in part from current export earnings and in part by drawing on the sterling balances that had been accumulated during the war and early post-war period. In 1955, at the beginning of the second plan, the external public-guaranteed debt stood at about $300 million, by the end of the plan in 1961 it had risen over sixfold to about $2 billion. During the third plan it trebled, reaching a total of about $6 billion in 1966. There was a twenty-fivefold expansion in the service charge during these ten years: it was a mere $12 million in 1955, and about $100 million in 1961 and over $300 million in 1966. And even

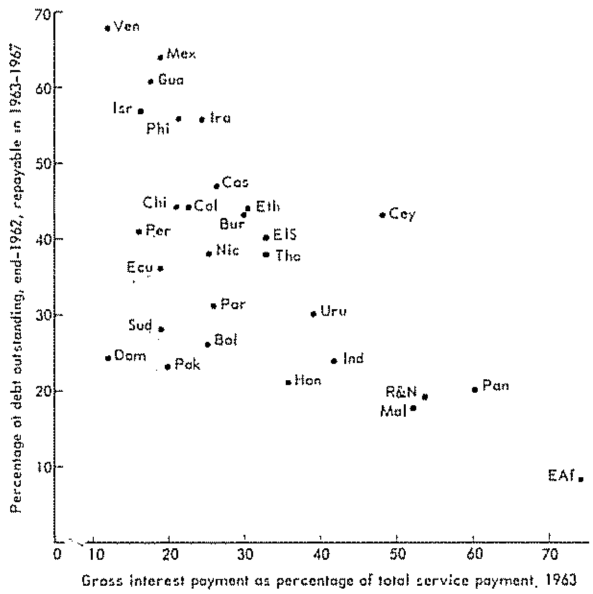
Figure XIII. Developing countries: Relation of composition of service payment to maturity of debt, 1962-1963



Bol	Bolivia	Ira	Iran
Bra	Brazil	Isr	Israel
Bur	Burma	Mal	Malaysia
Cey	Ceylon	Mex	Mexico
Chi	Chile	Nic	Nicaragua
Col	Colombia	Pak	Pakistan
Cos	Costa Rica	Pan	Panama
Dom	Dominican Republic	Par	Paraguay
EAf	East Africa	Per	Peru
Ecu	Ecuador	Phi	Philippines
EIS	El Salvador	R&N	Rhodesia and Nyasaland
Eth	Ethiopia	Sud	Sudan
Gua	Guatemala	Tha	Thailand
Hon	Honduras	Uru	Uruguay
Ind	India	Ven	Venezuela

Source and foot-notes as for figure II

Figure XIV. Debt service payment in developing countries: Composition and relative size, 1963



Bol	Bolivia	Isr	Israel
Bur	Burma	Mal	Malaysia
Cey	Ceylon	Mex	Mexico
Chi	Chile	Nic	Nicaragua
Col	Colombia	Pak	Pakistan
Cos	Costa Rica	Pan	Panama
Dom	Dominican Republic	Par	Paraguay
EAf	East Africa	Per	Peru
Ecu	Ecuador	Phi	Philippines
EIS	El Salvador	R&N	Rhodesia and Nyasaland
Eth	Ethiopia	Sud	Sudan
Gua	Guatemala	Tha	Thailand
Hon	Honduras	Uru	Uruguay
Ind	India	Ven	Venezuela
Ira	Iran		

Source and foot-notes as for figure II.

this upsurge understates the prospective burden: for most of the recent borrowing has been subject to lengthy "grace periods" postponing repayment —seven years for the loans arranged through the Aid-India Consortium and ten years in the case of United States loans—so that the full impact on the balance of payments will not begin to be felt until well into the fifth plan.

DEALING WITH THE DEBT BURDEN

In an increasing number of developing countries the rapid rise in the burden of service payments has been pre-empting so large a proportion of current earnings that ordinary import capacity is being curtailed and the possibility of further borrowing thrown into question. Several countries have run into balance of payments crises during the period under review and, being unable to meet maturing interest and repayment obligations, have had to seek relief from creditors.

So far, significant defaults have been avoided, but it is clear that if international lending is to continue, the indebtedness of the developing countries will have to be very carefully handled. The external needs associated with the process of development point to the importance of a country's maintaining it's "creditworthiness" and hence its ability to borrow both in connexion with long-term investment projects and for the purpose of meeting more immediate requirements. But this is not only a problem for the developing country; it is one in which the creditor countries have a deep interest—as members of the world community concerned with the developing country's growth problems and with the maintenance of international credit and liquidity, as creditors concerned with their position in relation to other claimants, and as traders desirous of expanding their exports to the developing countries.

Two distinct but interconnected sets of questions have to be faced—one arising from past borrowing and the difficulties countries may encounter in carrying the servicing burden that this will entail, and the other relating to future borrowing and lending policies, including the terms and conditions on which loans are made and the uses to which they are put.

In one sense the problems arising from past borrowing are merely those of proper foreign exchange budgeting. Recent experience has shown, however, that difficulties can arise on both sides of the process: on the one hand the extent and timing of maturing external liabilities are not always known with sufficient accuracy and on the other hand export proceeds remain subject to unpredictable fluctuations that are often large in relation to the volume of available external reserves. A year of heavy service charges and poor export performance may be enough to precipitate a payments crisis.

The countries that are most vulnerable are those with the highest proportion of short-term debt, the highest ratios of service charges to export receipts, the lowest ratios of external liquidity to import expenditures, the highest degree of commodity concentration in exports and the most stringent controls over imports (*see* table A.III-1 in the annex to this chapter). To reduce the risks of a sudden and disruptive crisis, the first requirement is an early warning system. This cannot be set up until external obligations are adequately documented; this includes information about private debt which is often of a relatively short-term nature and hence subject to rapid turnover, with repayments exceeding new credits during periods in which imports are being cut back.

Even sound foreign exchange budgeting and a satisfactory system for detecting impending stringency may not be sufficient to avoid balance of payments crises. In many developing countries export earnings are still affected very greatly by the outcome of particular harvests and the course of a particular price on world markets. The first line of defence in such a situation is the International Monetary Fund (IMF) which in recent years has provided an additional tranche of accommodation in order to assist developing countries to compensate for the sudden worsening of the external balance. Debate is now proceeding on the possibility of providing supplementary finance in cases where the IMF and other facilities are not enough to prevent a disruptive cutback.[10]

From time to time in recent years crises have developed, particularly in countries in which strong internal inflationary pressures have pushed domestic prices far out of line with those outside, thus further complicating the task of maintaining external balance in the face of export fluctuations. In these circumstances, bunching of external debt charges—the chances of which rise with the proportion of short-term obligations—has called for emergency action on the part of creditor countries in order to avoid defaults and all their disturbing consequences. This type of situation gave birth to the Paris Club and the Hague Club in the mid-nineteen fifties, and these informal groupings of creditor countries have engaged in a succession of debt rescheduling operations—for Argentina in 1956, 1963 and 1965, for Brazil in 1961 and 1964 and for Chile in 1964.[11] Uruguay arranged the consolidation of much of its short-term debt in 1965; and Ghana arranged a moratorium on some of its repayment obligations in 1966.

By action of this sort—moratorium, consolidation, rescheduling and refinancing—the existing debt burden has been prevented from doing as much damage as it might otherwise have done to the development of the debtor country, to the claims and trade of the creditor countries, and to the international credit structure. What has been involved in most cases is the spreading over time of previously incurred obligations so as to reduce their impact on the debtor country's external balance. This has inevitably affected its future capability of borrowing and it has sometimes been accompanied by efforts to persuade the country to pursue a more cautious economic policy, particularly in respect of the government's internal borrowing and the maintenance of the value of the currency.

Given the present debt structure, with its high capital burden that has not yet had any impact on current payments, it seem very likely that similar steps may have to be taken in respect of a number of other developing countries in the years immediately ahead. Only a marked improvement in their capacity to earn the foreign exchange necessary to service the obligations they have already incurred can prevent the debt from being a burden so onerous as to jeopardize their ability to finance current needs, let alone future development.

The implications of the existing pattern of debt pose grave problems regarding further lending operations. At issue are not only the terms on which loans are made but also the arrangements for repayments and even the use to which borrowed funds are put in the developing countries.

In some ways the terms and conditions governing transfers to the developing countries have become less favourable in recent years. Not only has there been a decline in the flexibility of the average transfer as a result of the spread of the various forms of tying and similar contraints discussed earlier in this

[10] *See* recommendation A.IV.18 of the first UNCTAD, reported on in a staff report of the IBRD. The matter has been referred by the UNCTAD Committee on Invisibles and Financing related to Trade to an intergovernmental group for further elaboration of a practical scheme.

[11] *See* also chapter V below, where these "clubs" are discussed in the context of international action.

chapter but the proportion of unrequited transfers has also been declining: in the case of bilateral commitments of the developed market economies, for example, grants—in cash and in kind—constituted over 60 per cent of the total at the beginning of the nineteen sixties but only 54 per cent in 1964. This trend reflects chiefly the switch from grants to loans in the United States aid programme

As far as loans are concerned, however, the trend has been towards easier terms, both in multilateral transfers (since the establishment of the IDA in 1960) and in transfers from the developed market economies. The weighted average of the bilateral commitments of developed market economies shows that in the first four years of the nineteen sixties loan maturity has lengthened from less than twenty-four years to almost twenty-eight years, and interest rate has declined from over 3.6 per cent *per annum* to about 3.1 per cent.

These averages conceal wide disparities among the practices of various lending countries. In 1964, for example, the proportion of grants in total bilateral commitments ranged from less than one-fourth in Austria, Italy, Japan and Portugal to over three-fourths in Belgium, France and Norway. And notwithstanding the stiffening of terms that occurred in the course of that year, the United States was still among the countries providing the "softest" loans. If allowance is made for both average maturity and average rate of interest, the "grant element"—the difference between the face value of the loan and the present value of future repayments, discounted at the market rate of interest—implicit in 1964 commitments ranged from less than 10 per cent of nominal value in the case of Canada, Denmark, Italy, Japan and the Netherlands to almost 30 per cent in the case of the United States (*see* table III-7).[12]

In 1964, the United States twice raised the minimum rate of interest on AID loans: in January the rate payable after the grace period was raised from 0.75 per cent to 2 per cent; and in October, rates were raised from 0.75 per cent to one per cent during the grace period and from 2 per cent to 2.5 per cent thereafter. On the other hand, notwithstanding tightening market conditions, several countries have taken steps to ease their lending terms: in 1964 Canada adopted a programme involving loans for fifty years at 0.75 per cent with a grace period of ten years, Italy and the Netherlands have used budgetary funds to subsidize interest rates, Japan extended its first soft loan in 1965 and the United Kingdom has been making increasing use of a system of interest waivers introduced in 1963. At its high-level meeting in July 1965, the Development Assistance Committee recommended that members "who do not already provide at least 70 per cent of their official assistance in the form of grants should endeavour to provide 80 per cent or more of their total official assistance at favourable terms, i.e. either as grants or as loans with long maturities (25 years or more), at low rates of interest (3 per cent or less) and that the average grace period on loans should be 7 years".[13]

The differences that such variations in loan terms can make to the service burden borne by the borrower are illustrated in figure XV which shows the growth of payments required to service loans totalling $500 million a year on terms that have typically been charged by some of the leading lenders.

With a given amount of gross borrowing each year, after fifteen years, service payment under relatively "soft" terms (of the AID type, namely 2.5 per cent interest, forty years' maturity and ten years' grace) will be somewhat less than half the amounts due on similar loans under relatively hard terms (of the IBRD type, namely 6 per cent interest, twenty-two years' maturity and four and a half year's grace). In general, the more favourable these three terms, the longer will be the period before the net flow of funds becomes negative: this occurs after ten years in the case of flows under the terms of the Export-Import Bank, thirteen and a half years in the case of IBRD-type loans, twenty-eight years in the case of AID loans, and forty-three years in the case of IDA loans. The main function of the grace period and the longer maturities is to postpone the debt service rather than to eliminate it. Indeed, after a certain lapse of time, the debt service for a given annual gross flow at a given rate of interest may actually be higher under "softer" repayment terms than under harder terms.

Softening of terms is not the only method of reducing the effective servicing burden. The impact of the borrower's balance of payments may be lessened by making the service charge payable in something other than convertible currency—the goods exported by the borrower, for example. This was done in a

[12] The IBRD lending rate was used for discounting in this illustration. If, instead of the IBRD rate, the local market discount rate in the lending country is used—thus providing a better measure of "cost" to the lender—the grant component range is somewhat different. If the rates used for discounting were those applicable in the borrowing country—thus reflecting the local opportunity cost of capital—the grant element would in general be appreciably greater.

It is clear that such comparisons are all very approximate for they fail to take into account a number of important variables—the distribution of loans by destination (to allow for differences in risk), the existence of tying and other constraints (to allow for differences in export prices and in balance of payments impact) and the conditions of repayment, for example.

[13] *See* Organisation for Economic Co-operation and Development, *Development Assistance Efforts and Policies, 1965 Review, Report of the Chairman of the Development Assistance Committee* (Paris, 1965), p. 16.

Table III-7. Selected developed market economies: Grant element implicit in official bilateral loan commitments, 1964

Country[a]	Maturity[b] (years)	Loan interest rate[b] (Percentage)	Market discount rate[c] (Percentage)	Grant element (percentage of loan): At market discount rate and grace period of 0 years	Grace period of 5 years	At discount rate of 5.8 per cent and grace period of 5 years
United States	33.7	3.1	5.2	21.3	24.2	29.6
France	13.8	3.1	6.1	16.0	21.5	19.3
United Kingdom	23.8	3.8	7.0	23.4	27.8	18.8
Belgium	15.0	3.5	6.6	17.2	22.2	17.1
Germany (Federal Republic)	17.8	4.3	7.2	17.6	21.9	15.8
Portugal	12.4	4.5	4.9	2.0	2.9	13.7
Denmark	15.0	4.5	7.2	14.6	18.9	9.7
Italy	7.8	4.4	7.3	9.4	15.4	7.7
Canada	20.8	5.0	6.2	8.5	10.3	7.0
Netherlands	23.5	5.1[d]	5.9	6.2	7.4	6.5
Japan	9.3	5.8	8.4	9.5	13.9	—

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on United Nations, *Monthly Bulletin of Statistics*, December 1965; International Monetary Fund, *International Financial Statistics* (Washington, D.C.), September 1965; Organisation for Economic Co-operation and Development, *Development Assistance Efforts and Polices, 1965 Review, Report of the Chairman of the Development Assistance Committee* and *Reappraisal of Foreign Aid Policies*, by Goram Ohlin (Paris, 1964); Bank of Japan, Statistical Department, *Economic Statistics of Japan* (Tokyo), March 1965; John A. Pincus, "The Cost of Foreign Aid", *Review of Economics and Statistics* (Cambridge, Massachusetts), November 1963; *Economic Aid and International Cost Sharing* (Baltimore, 1965).

[a] Countries are ranked in descending order of grant element, assuming a discount rate of 5.8 per cent *per annum* (the IBRD lending rate) and a grace period of five years. The relationship between the grant element of the loan and its terms is as follows:

Grant element, as percentage of face value

$$\text{of loan} = (1 - i/r)\left(1 - \frac{e^{-rG} - e^{-rM}}{rM - rG}\right),$$

where i = the loan interest rate
r = market discount rate, approximated by government long-term bond yield, plus one per cent
G = assumed grace period
M = maturity period of loan in years.

[b] Based on weighted average terms of official bilateral loan commitments in 1964.

[c] Government long-term bond yields plus one per cent.

[d] 1963 average.

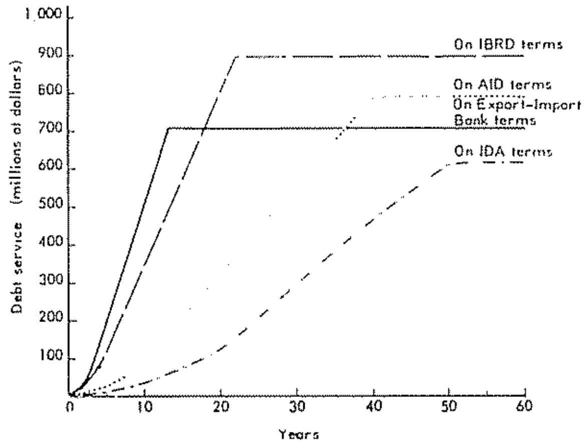
number of cases when the United States was actively adding to its stockpile of strategic commodities in the first half of the nineteen fifties. It is a method widely practised by the centrally planned economies: repayment of credits is accepted not only in terms of traditional commodities but even in terms of the output of the facilities which the credits have helped to establish.[14]

In a limited way such arrangements can be helpful. The difficulty that has proved most troublesome is the pricing of the goods passing in payment. Where these are primary commodities—which is usually likely to be the case—a price agreed to at the time of the loan may soon be found to be far out of line with actual market prices, and such differences have often generated dissatisfaction on one side or the other. In the case of the centrally planned economies, the usual practice has been to accept the price ruling on a designated free market. While such an arrangement has proved workable—and advantageous to the developing countries participating—when practised on a relatively small scale, its spread might serve to narrow the free market and hence increase instability. Though the countries that were able to meet their debt-service charge in this way might still benefit, other developing countries selling the commodity in question might be prejudiced. And a large and general extension of the system would tend to introduce into international trade a barter component that would probably be awkward for the more advanced countries and in the long run might handicap the developing countries, which on the whole stand to gain from flexibility and multilateralism.

The balance of payments may also be relieved of the full impact of the service charge if the lender is prepared to accept inconvertible currency instead of convertible currency. At one stage the United States Development Loan Fund accepted interest and amortization payments in local (recipient's) currency, and certain of the PL 480 commodity

[14] *See* chapter IV below for a discussion of these practices.

Figure XV. Relation between debt service and terms of financing



Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat.

Note: The terms of loans shown in the chart correspond to the usual terms currently applied by the four institutions. The actual disbursement of loans varies from case to case but simplifying assumptions have been adopted to approximate the drawing practice characteristic of each of the institutions.

(*a*) *Export-Import Bank*—5.5 per cent interest on balance outstanding; 2.5 years' grace on repayment of principal; thirteen years' maturity; repayment of principal and interest in equal semi-annual instalments. (It is assumed that the drawing of loans is in five equal semi-annual instalments of $100 million.)

(*b*) *International Bank for Reconstruction and Development*—6 per cent interest on balance outstanding plus 0.75 per cent commitment charge on undisbursed portion of loan; twenty-two years' maturity; 4.5 years' grace on repayment of principal; repayment of principal and interest in equal semi-annual instalments (It is assumed that the drawing of loans is in ten equal semi-annual instalments of $50 million.)

(*c*) *Agency for International Development*—2.5 per cent interest; forty years' maturity; ten years' grace on repayment of principal and one per cent interest during the grace period; repayment of principal and interest in equal semi-annual instalments. (It is assumed that the drawing of loans is in ten equal semi-annual instalments of $50 million.)

(*d*) *International Development Association*—0.75 per cent interest (service charge on balance outstanding); ten years' grace on repayment of principal; fifty years' maturity; repayment: one per cent of principal *per annum* for ten years, 3 per cent of principal *per annum* for thirty years (It is assumed that the drawing of loans is in five equal annual instalments of $100 million.)

transfers have also been financed by loans repayable in the recipient's currency. The result has not been very satisfactory from the lender's point of view. Currency that is accepted in order to assist a developing country cannot be used in disregard of the state of internal balance in the country in question; it may be accumulated in amounts much greater than the lending country can reasonably use; its purchasing power may shrink rather rapidly under the influence of inflation in the borrowing country. For these reasons the use of this device has not spread, and the proportion of United States transfers financed in this way has declined.

A modification of the idea that has proved more promising, however, is the so-called two-step loans made by the United States Agency for International Development. The terms of such loans are arranged in two separate transactions, one between the project management and the government in the developing country and the other between the latter and the United States. The service payments from the project are in local currency and may be earmarked for additional development finance. These loans are made on terms that are intended to meet the basic dichotomy that often exists between the investment the loan is to finance and the state of the economy—and especially the external balance—of the country that has to arrange for the servicing. The viability of the former is no guarantee of debt-servicing capacity of the latter; and, conversely, the charge levied on the investment need not be limited to that which the country's balance of payments is deemed capable of bearing. Two-step lending makes it possible to apply market criteria (in domestic currency) to the project and development aid criteria to the repayment terms prescribed for the borrowing country (in convertible currency).

The need to distinguish between the project and the country tends to increase with the distance of the former from the activities determining export receipts. As indicated earlier in this section, the growth of the external indebtedness of governments has not in fact been closely related to the growth of export receipts. Investment priorities are set by general development considerations of which export earning (or import saving) is only one. In the ten years ending in 1965, indeed, almost three-fourths of the amount lent by four of the principal institutions concerned with development finance went into infra-structure and other general forms of investment (*see* table III-8). Though, in the long run, growth-promoting investment of this nature may be expected to raise a developing country's export potential, in the shorter run there may be little benefit to export earnings. In many cases, indeed, the immediate effect is more likely to be some stimulation of imports. Hence, given the export structure that characterizes most developing countries, the balance of payments bottleneck will continue to limit the debt-servicing capacity.

While it is necessary, even desirable, to use interest rates as a controlling instrument in connexion with particular projects, they have less relevance when applied to the country as the debt-servicing entity. Development lending thus involves two separate criteria—the merits of the particular purpose and the debt-servicing capacity of the borrowing country. Where the debt burden is already heavy, the interest rate realistically applicable on the basis

Table III-8. Selected developing countries: Distribution of amount borrowed from major lending agencies, 1956-1965

(Percentage)

Lending agency, recipient region and country	*Transportation*	*Telecommunications*	*Power and electricity*	*Water supply and sewerage*	*Social and educational*[a]	*Total infrastructure*	*Agriculture*	*Industry*	*General development*[b]	*Percentage of public-guaranteed debt held by IBRD, IDA, AID and Export-Import Bank*[c]
By source:[d]										
IBRD	37	1	39	1	—	77	6	13	4	
IDA	43	9	7	6	4	68	20	11	—	
United States AID	10	—	11	1	3	25	4	10	62	
United States Export-Import Bank	16	—	5	1	—	22	2	47	29	
Total, above	22	1	17	1	1	42	5	23	31	
By recipient:										
Latin America	20	—	19	1	2	41	6	25	29	
Argentina	15	—	11	—	—	26	3	40	31	23[e]
Brazil	20	—	20	—	1	41	3	17	39	
Chile	6	—	12	—	—	18	3	30	49	50
Colombia	17	—	23	1	2	43	3	21	32	74
Costa Rica	24	11	26	7	2	71	14	7	9	66
Ecuador	47	1	16	—	4	67	—	18	15	76
El Salvador	22	13	17	—	8	60	12	15	13	91
Guatemala	22	—	—	—	7	28	2	48	22	46
Honduras	53	—	20	2	6	81	4	4	11	73
Mexico	24	—	20	—	2	46	8	29	17	31
Nicaragua	20	—	37	5	2	64	20	14	2	76
Panama	49	—	5	10	—	64	3	3	30	56
Peru	35	—	12	5	3	55	13	19	13	34
Uruguay	24	—	34	2	7	67	22	6	6	
Venezuela	19	—	29	—	4	52	3	25	20	69
Asia[e]	24	2	12	1	1	40	6	19	36	
India	24	2	15	—	—	41	2	19	38	
Indonesia	10	—	—	—	—	10	—	71	19	
Iran	43	—	4	—	—	48	15	6	31	32
Israel	24	—	1	—	1	25	14	30	31	68
Pakistan	22	—	7	4	2	36	9	17	39	59
Philippines	4	3	15	5	2	29	—	28	43	66
Thailand	37	—	37	—	—	74	17	9	—	
Africa	16	1	39	1	4	61	—	38	1	
Ethiopia	53	3	28	—	—	84	—	8	8	63
Ghana	—	—	34	—	—	34	—	66	—	34
Liberia	4	—	28	5	7	45	—	55	—	83
Nigeria	27	1	56	—	10	93	—	6	1	92

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on International Bank for Reconstruction and Development, and International Development Association, *Annual Report* (Washington, D.C.); Export-Import Bank of Washington, *Report to the Congress* (Washington D.C.); Office of the Controller, Agency for International Development, *Status of Loan Agreements as at 30 September 1965* (Washington, D.C.).

[a] Including housing, medical and education projects and personnel training.

[b] Including loans for banks, non-project and unspecified project assistance; economic development; imports and other commodity assistance; budgetary support; financing sub-loans; administrative and fiscal reform; feasibility studies, and investigative and consultative services.

[c] December 1964. Data for Argentina refer to October 1964.

[d] As a proportion of the amount lent to developing countries, the sample covers 82 per cent in the case of the IBRD, 88 per cent for the IDA and 86 per cent for AID. In the case of the Export-Import Bank, the data refer to authorizations of credits relating to the developing countries under the following headings: project and equipment loans; commodity credits; exporter credits, and emergency foreign trade credits.

[e] Including IBRD loans to Burma and Ceylon for transportation and telecommunications, respectively.

of the second criterion may be far below what may be appropriate under the first.

Just as the trend towards softer loans should in principle be facilitated by international consultation and action, the evolution of so-called "aid consortia" and "consultative groups" should make it easier for the broader view of the financing problem to be taken by lending countries. And in this perspective a capital transfer is less likely to be arranged and priced solely on the basis of the viability of the project for which it is ostensibly to be made, and the over-all impact of the investment—both on domestic growth and on external payments—is more likely to be given due consideration.

By making it easier to "harmonize" the terms of transfer among capital exporting countries, the prospects for making them more favourable to the develing country are improved. On the one hand the fear that by granting softer terms one country is merely facilitating the financing of harder loans from other countries is materially diminished by a joint approach. And on the other hand the higher degree of surveillance—in its least objectionable (international) form—that is implicit in the consortium type of arrangement is likely to reduce further the reliance on the rate of interest as a means of ensuring the proper use of scarce capital for international development finance. If the international consultation is on a systematic basis, moreover, it should facilitate the organization of early action if signs of payments difficulties arise.

The international approach may also be convenient for facing up to the opposite side of the debt-servicing problem, namely, the borrower's capacity to earn foreign exchange. In so far as the lending countries play a key role in determining the magnitude of the developing countries' export receipts there is an obvious advantage in having the terms of financing discussed against a background of trade prospects. In the long run, measures to raise the debt-servicing capacity of a developing country are likely to prove more important than the softening of the terms of a particular loan.

Annex

Table A.III-1. Selected developing market economies: Changes in indicators of debt servicing capacity, 1956-1964

(Percentage)

Country[a]	*Average ratio of debt service to export earnings*[b]		*Average annual rate of increase in debt service,*[b,d] *1956-1964*[e]	*Average annual rate of increase in export receipts,*[d] *1956-1964*	*Average annual rate of increase in gross national product,*[d,f] *1956-1963*[g]	*Share of principal commodity in total exports, 1964*[h]	*Average annual rate of increase in reserves,*[d,i] *1956-1964*[j]	*Ratio of reserves*[i] *to imports. 1964*	*Average annual rate of increase in cost of living,*[d] *1956-1964*[k]
	1956-1958	*1962-1964*[c]							
Chile	10.2	20.7	13.4	1.7	4.5	66.3[h]	1.3	14.6	26.0
Argentina	6.5	20.5	46.9	5.1	1.1	23.3	—10.8	14.2	33.1
Israel	34.2	20.3	9.1	16.8	9.7	36.6	32.1	66.0	5.1
Mexico	7.4	20.1	22.1	3.0	5.5	16.1	1.6	39.4	3.7
Brazil	14.2	19.9[c]	9.2[e]	—0.4	5.6	53.0	—6.2	29.1	42.9
Colombia	11.8	14.7	12.9	—1.3	3.9	73.5	—0.6	21.2	12.3
Bolivia	5.2	12.6	19.7	0.7	2.4	71.6	47.1	22.7	17.8
India	1.1	11.3	47.4	3.8	3.5[g]	18.8	—12.6	19.1	4.8
Ecuador	5.8	10.5	12.6	3.1	4.3	56.6	5.5	30.8	2.5
Costa Rica	4.0	9.1	19.7	6.8	5.9[g]	42.2	4.8	13.7	2.2
Pakistan	7.4	9.0	15.3	2.9	3.9	37.0[h]	—3.2	24.4	2.7
Peru	7.9	8.9	11.4	10.1	5.9	21.5	10.3	28.0	7.6[k]
Guatemala	0.4	7.0[c]	79.0[e]	3.1	4.4	45.8	—2.1	29.7	—
Iran	4.4	7.0[c]	38.8[e]	11.9	4.7[g]	88.5	—1.7	29.6	1.9[k]
Sudan	0.3	6.9	54.8	0.3	5.0[g]	47.5	—11.7	26.5	3.3
Philippines	1.5	5.9	28.4	6.4	4.6	33.2	—3.4	14.2	3.7
Ethiopia	1.6	5.4	37.6	6.6	4.6[g]	60.5	—2.5[j]	49.6	3.9[k]
Uruguay	6.1	5.4[c]	1.5[e]	—2.0	—0.3	41.5	1.7	96.0	25.4
Nicaragua	5.2	4.5	5.4	9.3	6.1	17.9	23.9	28.5	—
Venezuela	0.7	4.1	35.1	3.3	5.6	93.0	—1.7	71.9	1.1
Burma	0.3	3.6	53.0	—0.8	5.7	62.0	6.7	74.6	0.1[k]
Thailand	2.0	3.5	21.8	6.6	6.7	35.8	9.6	99.0	2.0
El Salvador	1.2	3.4	22.3	5.9	5.0	52.4	3.9	27.7	0.1
Nigeria	0.6	2.7	30.1	6.0	3.2[g]	19.8	—12.6[j]	36.0	3.0
Honduras	0.6	2.6	30.6	3.3	4.3[g]	36.1	1.3	19.6	1.3
Panama	2.4	2.3	25.1	10.3	7.0[g]	43.3	—9.4	9.6	0.5
Ceylon	0.6	1.6	11.7	1.0	4.5	60.8	—17.4	12.3	1.5
Malaya (Federation of)		0.5[c]	12.2[e]	2.6	5.1[g]	44.9	6.8	109.2	1.0[k]

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on data from Statistical Office of the United Nations, International Bank for Reconstruction and Development, International Monetary Fund and Organisation for Economic Co-operation and Development.

[a] Countries are arranged in descending order of the ratio of debt service to export earnings in 1962-1964.

[b] Debt service is the interest and amortization payments in respect of public-guaranteed debt.

[c] 1961-1963 for Brazil, Federation of Malaya, Guatemala, Iran and Uruguay.

[d] Compound rate between terminal years. As some of the variables—particularly exports and reserves—are subject to considerable year-to-year fluctuations, these rates of change do not necessarily reflect trends.

[e] 1956-1963 for Brazil, Federation of Malaya, Guatemala, Iran and Uruguay.

[f] At constant (1960) prices.

[g] 1956-1962 for Costa Rica, Federation of Malaya, Honduras, India, Nigeria, Panama, Sudan; 1958-1963 for Ethiopia; 1956-1961 for Iran.

[h] 1963 for Chile and Pakistan.

[i] Foreign exchange, gold and position with the IMF.

[j] 1962-1964 for Ethiopia; 1959-1964 for Nigeria.

[k] 1956-1963 for Burma; 1957-1964 for Ethiopia and Federation of Malaya; 1960-1964 for Iran and Peru.

Chapter IV

THE FLOW OF RESOURCES FROM THE CENTRALLY PLANNED ECONOMIES

The volume, terms and conditions of aid to developing countries[1]

THE VOLUME OF CREDIT GRANTED

The aid given by the centrally planned economies to the developing countries was very small until 1955. Since then it has been increasing continuously in size and in geographical coverage except for setbacks in 1962 and 1963. In 1964 the amount of credits extended to developing countries rose considerably again, reaching $1.2 billion—the highest amount ever granted during a single year. According to the information presented in table IV-1, which refers only to the credits and grants specified in individual announcements and may therefore differ from the totals actually extended, the total commitments during the period of 1955-1964 amounted to about $5.9 billion and, together with grants, to over $6 billion.

The largest share of this total, over 60 per cent, was extended by the Soviet Union, followed by mainland China, which accounted for about 13 per cent. Czechoslovakia and Poland followed next with shares of 10 per cent and 6 per cent, respectively. The participation of Eastern Germany, Hungary and Romania amounted to about 3 per cent each of the total, and that of Bulgaria to less than one-half of one per cent.

The participation of individual centrally planned economies in the aid given to the developing countries has undergone considerable changes during the period under review. Thus, while the contributions of the centrally planned economies other than the Soviet Union were very small during the first part of this period, their share in the total has increased considerably in the subsequent years.

Although little is known about the actual flows of credit from the centrally planned economies to developing countries during 1955-1964, available qualitative and quantitative information indicates that the changes in the volume of disbursements were not, as a rule, proportional to the growth of credit commitments. As most of the credits were offered in the form of delivery of machinery and equipment for construction of new plants, their utilization obviously depended largely on the completion of the basic construction works in the receiving country. Moreover, the credit agreements were frequently announced before the beginning of the preparatory works and surveys. In consequence, the time spent between commitments and utilization tends to vary considerably, depending not only on the size and characteristics of the project but also on timing and the ability of credit receiving countries to organize and complete those parts of a given project which are to be executed by the use of internal resources. On the average the disbursement period has lasted about five years, counting from the time of the first deliveries.

According to very rough estimates, about one-quarter to one-third of total credits committed between 1954 and 1964, had been utilized by the end of 1964. A certain indication of the disbursement of credits can be derived from the data on exports of complete plants and installations to the developing countries which represent the major part of the actual credit flows. Such data covering the period under review are available only for the Soviet Union (*see* table IV-2). The credit flows as revealed by these data rose from about $1 million in 1955 to $112 million in 1958. During the two following years, these flows declined to about $67 million annually, but in 1961 they rose to about $137 million and in 1964 they reached an all-time peak of $296 million. Total exports of complete plants and installations between 1955 and 1964 amounted to about $1.1 billion, that is, to about 31 per cent of the total commitments of the Soviet Union. The ratios of deliveries of complete plants and installations to commitments were above this average for India, Iraq and Afghanistan, but below it for the United Arab Republic, Ceylon and Indonesia.[2] The differences among countries depended not only on the time interval separating the announcement and the disbursement of credits but also on the rate of growth and timing

[1] In this chapter the term "aid" is used in a generic sense. Most of the aid provided by the centrally planned economies to developing countries has been in the form of long-term development credits.

[2] These percentages were: India, 64 per cent; Iraq, 52 per cent; Afghanistan, 39 per cent; United Arab Republic, 25 per cent; Ceylon, 19 per cent; Indonesia, 13 per cent.

Table IV-1. Centrally planned economies: Commitments of bilateral economic assistance to developing countries, 1955-1964[a]

(Millions of dollars)

Item and country	*Total, 1955-1964*	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*	*1961*	*1962*	*1963*	*1964*
Total commitments	6,029	162	283	354	588	866	868	1,005	316	341	1,246
Distribution by source:											
Bulgaria	26	—	—	—	—	—	—	18	2	6	—
China (mainland)	758	—	55	16	48	36	45	154	11	88	305
Czechoslovakia	601	5	4	57	59	76	115	146	1	20	118
Eastern Germany	179	15	—	—	20	—	27	46	—	—	71
Hungary	175	6	—	—	—	—	34	111	—	14	10
Poland	394	—	2	—	39	10	65	128	88	8	54
Romania	182	—	—	—	12	—	—	100	—	—	70
USSR	3,714	136	222	281	410	744	582	302	214	205	618
Distribution by destination:											
Latin America	381	4	2	—	100	5	—	270	—	—	—
Argentina	109	4	—	—	100	5	—	—	—	—	—
Brazil	272	—	2	—	—	—	—	270	—	—	—
West Asia	651	—	20	150	32	138	124	—	15	75	97
Iran	84	—	—	—	—	—	—	—	—	59	25
Iraq	217	—	—	—	—	138	79	—	—	—	—
Syria	231	—	—	150	—	—	45	—	15	16	5
Yemen	119	—	20	—	32	—	—	—	—	—	67
Far East	2,579	145	256	147	159	576	330	421	246	24	275
Afghanistan	347	—	100	—	—	20	—	—	200	—	27
Burma	92	—	—	—	4	—	—	84	—	4	—
Cambodia	46	—	22	—	6	6	—	—	—	12	—
Ceylon	80	—	4	16	41	—	—	—	11	8	—
India	1,038	136	2	125	15	470	30	142	34	—	84
Indonesia	793	9	115	6	93	67	280	157	1	—	65
Nepal	51	—	13	—	—	10	20	8	—	—	—
Pakistan	132	—	—	—	—	3	—	30	—	—	99
Africa	2,418	13	5	57	297	147	414	314	55	242	874
Algeria	299	—	—	—	—	—	—	—	—	156	143
Central African Republic	4	—	—	—	—	—	—	—	—	—	4
Congo (Brazzaville)	33	—	—	—	—	—	—	—	—	—	33
Ethiopia	114										
Ghana	144	—	—	—	2	112	—	—	—	—	—
Guinea	119	—	—	—	—	—	40	82	—	—	22
Kenya	55	—	—	—	—	35	59	12	13	—	—
Mali	112	—	—	—	—	—	—	—	—	—	55
Morocco	17	—	—	—	—	—	—	75	10	—	27
Senegal	7	—	—	—	—	—	5	—	12	—	—
Somalia	96	—	—	—	—	—	—	—	—	—	7
Sudan	22	—	—	—	—	—	—	74	—	22	—
Tanzania	51	—	—	—	—	—	—	22	—	—	—
Tunisia	48	—	—	—	—	—	—	—	—	—	51
Uganda	15	—	—	—	—	—	10	38	—	—	—
United Arab Re-		—	—	—	—	—	—	—	—	—	15
public	1,282	13	5	57	295	—	300	11	20	64	517

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on the following: Bank for International Settlements, Bulletin (Basle); Government of India, Ministry of Finance, *External Assistance* for the years 1964 and 1965 (Delhi); *Dengi i Kredit*, No 6, 1962; Nos. 4, 7, 9, 1963; Nos 3, 7, 12, 1964; Nos 2, 3, 5, 1965; No 2, 1966 (Moscow); *Byulleten Inostrannoy Kommercheskoy Informatsii* (Moscow); *Far Eastern Economic Review* (Hong Kong), 19 January 1961, and other official and unofficial information

[a] Data differ from those presented in earlier versions of this table The changes reflect revisions both of totals and of year-by-year distribution; they have been made in the light of the latest available information. Data refer only to credits and grants reported in announcements referring to specific countries; they may differ from the totals actually granted by the centrally planned economies

of commitments. Thus, the concentration of large commitments during recent years would naturally result in the lowering of the ratio of disbursements to total commitments.

The relation between the commitments and utilization can be traced in more detail for India and Ceylon, the only two developing countries which have published data concerning the utilization of

Table IV-2. Soviet Union: Exports of complete plants to credit receiving countries, 1955-1964

Year	*Millions of dollars*	*Percentage of total exports*[a]
1955	1.1	3.3
1956	7.5	7.3
1957	47.2	23.4
1958	112.0	38.8
1959	67.8	27.2
1960	64.9	28.8
1961	137.3	34.2
1962	182.1	39.8
1963	220.6	36.9
1964	295.5	47.8

Source: *Vneshnyaya Torgovlya SSSR* (Moscow), for the years 1959-1963 and 1964.

[a] Exports to credit receiving countries

loans over a number of years (*see* table IV-3). These data indicate that over 50 per cent of credit committed by the centrally planned economies to India in 1955-1964 had been disbursed by the end of the period.[3] The major part of this was accounted for by Soviet credit disbursements which amounted to about 60 per cent of total Soviet commitments to India. The data relating to Ceylon show that 22 per cent of the commitments made by the centrally planned economies to this country in 1950-1963 were disbursed up to September 1963.

DISTRIBUTION OF AID

Although the centrally planned economies were providing aid to over thirty developing countries, the data on distribution of aid among recipient countries indicate a heavy concentration on a limited number of countries. Thus, 67 per cent of the total credits allocated to the Far East and West Asia was extended to three countries: Afghanistan, India and Indonesia. In Africa, more than half of the total allocated to the area went to the United Arab

[3] The disbursements of credit granted to India during the same period by other countries represented about 57 per cent of their commitments.

Table IV-3. Commitments of credit by the centrally planned economies to Ceylon and India, and its utilization[a]

(Millions of dollars)

Dispensing country and year	*Commitments*	*Contracts placed*	*Utilization*
Credits granted to Ceylon, 1950-1963			
Czechoslovakia (1950)	4.0	2.0	1.5
China (mainland) (1957-1962)	36.8[b]	—	10.9
Poland (1963)	8.0	—	—
USSR (1955)	30.0	17.5	4.8
Total	78.8	19.5	17.2
Credits granted to India, 1955-1964[c]			
Czechoslovakia (1959)	49.0	36.0	10.0
(1964)	84.0	—	—
Poland (1960)	30.0	27.5	16.0
(1962)	33.0	—	—
Romania (1958)	12.0	—	12.0
USSR[d] (1955)	136.0	—	136.0
(1957)	125.0	104.0	87.0
(1959)	420.0	364.0	235.0
(1961)	125.0	40.0	25.0
Total	1,014.0	571.5	521.0

Source: Government of Ceylon, Ministry of Finance, *External Economic Assistance* (Colombo, 1964); Government of India, Ministry of Finance, *External Assistance, 1964*.

[a] Not including commitments of Yugoslavia, which granted $40 million to India and $15 million to Ceylon.

[b] Of which, $26.3 million represented grants.

[c] In addition, in 1965 the Soviet Union extended to India a credit of $211 million for the construction of the Bokaro steel plant, and Poland a credit of $22 million.

[d] 1955 credit for construction of the Bhilai steel plant; 1957 credit for various industrial projects; 1959 credit for projects in the pharmaceutical industry, the Barauni oil refinery and projects included in the third development plan; 1961 credit, the second for third plan projects

Republic. Of the total credits and grants allocated to all developing countries, $3 billion—57 per cent—were allocated to these four countries.

The concentration of credits on a limited number of countries was one of the factors that accounted for the impact of the aid of the centrally planned economies being more significant than their share in the total aid given to developing countries would suggest. Another factor which increased the overall effect of these credits was that in most cases they were directed towards the expansion of investment goods industries and were accompanied by an extensive training of manpower, with a view to enabling the nationals of the recipient country to take over the construction and operation of future projects.

The part played by credits extended by the centrally planned economies in the development financing of the credit receiving countries cannot be easily assessed for lack of adequate statistical data. According to a United Arab Republic source, over one-third of total loans received by the United Arab Republic in 1952-1962 came from the centrally planned economies.[4] According to Soviet sources, credits offered by the Soviet Union to Afghanistan were equivalent to about one-third of total investment during the first five-year plan and to about one-half during the second five-year plan. In Guinea, credit commitments of the centrally planned economies were reported to represent 85 per cent of all credits extended to that country in 1960-1963 in connexion with its first three-year plan. This was equivalent to 70 per cent of total investment during the same period. According to Indian sources, the loans and grants of the centrally planned economies amounted to 13 per cent of all loans and grants extended to that country up to 1965.[5] The loans of the centrally planned economies earmarked for projects in power, minerals and manufacturing during to third plan, 1961-1966, amounted to about 20 per cent of total investment in these industries.[6] The credits granted to Ceylon amounted to about 32 per cent of all loans received between 1950 and 1964.[7]

No information is available from the centrally planned economies regarding the annual flows of credits to developing countries and the return flows of repayments of principal and interest to the centrally planned economies. Nor is the information available from the recipient side comprehensive: it covers only the years 1960-1964 and during that period only eleven countries reported, only three reporting for all the five years (*see* table IV-4). In view of these limitations, the annual variations in flows reflected in the data summarized in the table may not correspond to actual changes in total disbursements and repayments of credits granted by the centrally planned economies to developing countries. The correspondence between the recorded dis-

[4] *See* Said El-Naggar, *Foreign Aid to United Arab Republic*, United Arab Republic Institute of National Planning

[5] Total loans and grants, inclusive of those extended to India by the International Bank for Reconstruction and Development, the International Development Association, the United Nations Special Fund, and the United States Wheat Loans.

[6] Inclusive of the $210 million loan granted in 1965 for the construction of the Bokaro steel mill.

[7] Together with the loans extended by Yugoslavia, this share was equal to about 40 per cent of the total

Table IV-4. Disbursements and repayments of loans of the centrally planned economies to developing countries, 1960-1964

(Millions of dollars)

Item	1960[a]		1961[b]		1962[c]		1963[d]		1964[e]	
	Total	USSR	Total	USSR	Total	USSR	Total	USSR	Total	USSR
Drawings[f]	80.8	9.3	69.0	9.7	275.9	146.9	215.8	181.6	183.7	150.4
Percentage of exports	27.2	14.5	20.3	7.5	43.3	47.7	26.2	40.0	55.3	55.2
Repayments[g]	34.6	20.2	36.0	16.3	62.9	27.6	92.8	67.3	21.9	17.7
Percentage of imports	9.8	18.7	10.3	14.8	10.6	13.8	12.2	23.3	5.6	8.6

Source: International Monetary Fund, *Balance of Payments Yearbook* (Washington, D.C.), and Special Questionnaire issued jointly by the United Nations Secretariat and the International Monetary Fund. For further details, *see* United Nations, *International Flow of Long-term Capital and Official Donations, 1961-1965* (Sales No.: 66.II.D.3).

[a] For total: Brazil, Ceylon, Ethiopia, India, Indonesia and Sudan; for USSR: Ceylon, India and Indonesia

[b] For total: Brazil, Ceylon, Ethiopia, India, Indonesia and Sudan; for USSR: Ceylon, Ethiopia, India and Indonesia.

[c] For total: Brazil, Ceylon, Ghana, India, Indonesia, Pakistan, Somali Republic, Sudan, United Arab Republic; for USSR: Ceylon, India, Indonesia, Somali Republic, Sudan, United Arab Republic.

[d] For total: Brazil, Burma, Ceylon, Ethiopia, Ghana, India, Indonesia, Somali Republic, Sudan, United Arab Republic; for USSR: Burma, Ceylon, Ethiopia, India, Indonesia, Somali Republic, Sudan, United Arab Republic.

[e] For total and for USSR: Burma, Ceylon, Ethiopia, India, Sudan.

[f] Drawings of the developing countries. Exports from the centrally planned economies to credit receiving countries.

[g] Repayments to the centrally planned economies. Imports of the centrally planned economies from credit receiving countries

bursement and repayments and the trade flows for the same countries was not very close.[8] In 1962 and 1964, reported drawings on credits from the centrally planned economies amounted, respectively, to about 40 and 50 per cent of their exports to the developing countries concerned, but in the other years indicated in the table the proportion was appreciably lower (about one-fourth). The repayments amounted to about 10 per cent of the imports of the centrally planned economies from the developing countries in question in 1960-1964, but the proportion fell to about half that figure in 1964.

Although the credits extended by the centrally planned economies were used for the construction of a large variety of projects, more than half of the resources put at the disposal of the developing countries by countries members of the Council for Mutual Economic Assistance (CMEA) have been used for enterprises in heavy industry and power generation. According to a *communiqué* of the CMEA presented in 1964 to the United Nations Conference on Trade and Development,[9] about 35 per cent of credits were used for power stations, metallurgical plants and the coal industry, and 25 per cent were allocated to the chemical industry, oil refineries, engineering and building materials industries; the remaining credits were used for the construction of transport and communication facilities, geological surveys, prospecting, the construction of enterprises in light and food industries as well as of scientific, medical and educational institutions and housing. The same source put the capacity of power stations built with the aid of the CMEA countries at 5.2 million kilowatts, or about one-third of the capacity existing in the countries in which they were built. The capacity of the metallurgical plants constructed with the assistance of the centrally planned economies is expected to increase to 3.5 million tons of steel, thus doubling the existing capacity of publicly owned steel plants in the credit receiving countries. The capacity of oil refineries built with the assistance of the centrally planned economies amounts to 10 million tons of oil, that is over 50 per cent of the available capacity in the assisted countries. The capacity of new cement factories is equal to about 2.5 million tons, which represents almost 13 per cent of the capacity already installed.

TECHNICAL ASSISTANCE

The extension of investment credit was closely associated with technical assistance in the form of providing the recipient countries with technical experts and qualified workers, and in various forms of training of nationals of the recipient countries. A significant feature of this form of assistance was the particular attention devoted to the widest possible participation of the technical personnel of the recipient country in the preparation of the projects. This practice was intended to enable the personnel of the recipient country to become acquainted with the methods used by the experts of the donor country and to use the acquired experience for future work, thus lessening the dependence on foreign technical assistance. This aspect of technical assistance was even more important during the construction stage of the new projects. On-the-job training of engineers, construction workers and other qualified labour, facilitated by the presence of engineers and qualified workers from the donor countries, has frequently enabled the recipient countries to continue the construction work with its own labour. Similarly, a considerable number of technicians from developing countries were trained in the donor countries in plants similar to those under construction, with a view to their acquiring the skills necessary to operate the new plants efficiently. According to Soviet sources, during recent years about 100,000 skilled workers and technicians have been trained by the Soviet Union alone. No recent data are available on the number of experts and qualified workers from CMEA countries sent to developing countries on technical assistance, but in 1962 their number amounted to 7,000.

CREDIT TERMS AND CONDITIONS

The credits granted by the centrally planned economies are offered almost exclusively in the form of goods and services. They are based on bilateral agreements, and as a rule cover the cost of prospecting and exploration, preparation of blueprints and training of personnel, cost of equipment, machinery and technical assistance personnel as well as necessary materials which are not available in the credit receiving country. With some exceptions, the credits are given for the construction of specific projects stipulated in the agreements. As a rule, the credits are to be utilized within a period of four to five years, beginning with the date of the final arrangement, although in some cases the time spent between the signing of the agreement and the completion of a project has been considerably longer. Credits carry an interest rate of 2.5 to 3 per cent, and are repayable over a period of eight to fifteen years, beginning one year after the completion of the project or of deliveries of machinery and equipment. The interest accrues from the date of disbursement of each fraction of total credit and is paid within the first three months of the following year. Both the principal and the interest are re-

[8] The countries reporting the rise and repayment of credits from the centrally planned economies accounted for about 40 per cent of the latter's trade with the developing countries as a whole in 1962 and for 55 per cent in 1963, but for less than one-fourth in 1960, 1961 and 1964.

[9] *See* United Nations, *Proceedings of the United Nations Conference on Trade and Development, Volume VII. Trade Expansion and Regional Groupings* (Sales No.: 64.II.B.17), pp. 334-335.

payable in the form of commodity exports of the recipient country or, upon mutual agreement, in domestic currency or in convertible currency. The predominant, if not exclusive, form of repayment has been that of traditional exports of commodities and, in some cases, repayment has been made through exports of goods produced by the plants built with the aid of the foreign credits. Only a limited amount of these payments has been used by the creditor country for financing of local expenses of its personnel. Formally, the sums due for repayment of principal and interest are deposited into the bank account of the creditor country in the national currency of the debtor country. Prices of goods and services delivered by the donor country as well as those of goods used by the recipient country for the repayment of loans are as a rule based on prices prevailing in world markets. The credit agreements contain a gold clause which represents a guarantee against the effect of devaluation and inflationary price changes in the debtor country. No guarantee exists, however, against the effect of changes in world prices. Changes in the terms of trade may therefore have a considerable effect on the real cost of credit for each of the partners to the agreement.

The fact that these loans are extended in kind rather than in convertible currency and that they are generally earmarked for specific projects, make them subject to the familiar criticism applied to project financing and to tied loans, which has been discussed in the preceding chapter. But several features of the loans extended by the centrally planned economies are generally considered as particularly favourable to developing countries. Thus, the provision allowing for repayment in the form of traditional exports rather than in convertible currency has been particularly important in view of the balance of payments problems. The fact that the repayment of principal starts only after the completion of a given project gives these credits a self-liquidating character especially when repayment is effected by export of goods produced by the enterprises built with the aid of these credits. An important feature of the credit policy of the centrally planned economies is that the selection of specific projects is not made dependent on the views of the lending country concerning the most efficient allocation of resources by the recipient country. In this respect the final decision has been left to the government of the recipient country. Thus, for instance, projects in heavy industry have not been less eligible for loans than have projects in light industry in spite of the fact that profitability evaluation might give preference to the latter. Another characteristic of the aid of the centrally planned economies has been that the appropriate organizations of the donor country have taken the responsibility for construction and for handing over of the enterprise to the receiving country as a going concern. This responsibility has included all the technical assistance required for the completion of the projects. The loans extended by the centrally planned economies have been at low interest rates, charged only on the utilized fraction of loans, net of repayment.

The lack of adequate information concerning specific projects, quality and prices of goods delivered for their construction and other conditions prevent any quantitative assessment of the value of these features.[10] The only available estimates made recently in the Soviet Union were published with little information concerning the methods used in these calculations. According to these estimates, the more favourable terms of credit offered by the centrally planned economies resulted in quite considerable savings to the developing countries. One such estimate put these savings at 550-750 million roubles, representing the difference between the repayment of principal and interest on loans granted by the centrally planned economies to developing countries in 1954-1963 (4 billion roubles) and the amounts which the developing countries would have had to pay for the same amounts of loans to "western countries, international banks and organizations, and private investors".[11] Another Soviet estimate indicates that the savings due to lower interest rates on the loans granted by the centrally planned economies to developing countries would amount to about 20 per cent of the principal.[12] This evaluation is evidently based on the assumed difference of 3 percentage points between the interest rate charged by the centrally planned economies and that of the developed market economies, presumably assessed, in conformity with Soviet practice, on the utilized credits net of repayment.

These assumptions concerning the differences in the interest rates may hold for comparison with private investment loans, loans granted by certain agencies such as the Export-Import Bank or the World Bank and for official bilateral commitments of certain countries during certain periods. They may even correspond to weighted average rates for all loans allocated in the past to projects similar to those financed by the credit of the centrally planned economies. But they do not correspond to the differences between the interest rates charged by the centrally planned economies and those applied to the

[10] For problems involved in measuring flow of resources, *see* "Measurement of the Flow of Long-Term Capital and Official Donations to Developing Countries: Concepts and Methodology, Report of the Secretary-General" (A/5732), and "The Measurement of the Flow of Resources from the Developed Market Economies to the Developing Countries. Interim Report of the Group of Experts appointed by the Secretary-General" (E/4171).

[11] See *Voprosy Ekonomiki*, No 2, 1965 (Moscow), p 73

[12] *See* G M. Prokhorov, *Dve Mirovye Systemy i Osvobodivshiesya Strany* (Moscow, 1965), p 110.

official bilateral loans of the developed market economies in 1962-1964. The reduction in interest rates on these loans during recent years has brought them much closer to those charged by the centrally planned economies. Thus, while in 1961 nine-tenths of the bilateral commitments of the developed market economies were extended at interest of more than 3 per cent *per annum*, and seven-tenths at more than 5 per cent, in 1964 this proportion declined to less than one-half and about one-fourth, respectively. The weighted average interest rate on official bilateral loans of the countries members of the Development Assistance Committee (DAC) amounted to 3.6 per cent in 1962, 3.4 per cent in 1963 and 3.1 per cent in 1964. The weighted average for the DAC countries other than the United States was substantially higher, amounting to 5.2 per cent, 4.9 per cent and 4.2 per cent, respectively.[13]

PROCEDURE OF CREDIT ARRANGEMENTS

The framework and procedure of credit arrangements between the centrally planned economies and the developing countries are largely determined by the institutional characteristics of the former countries. The state ownership of productive facilities and the central planning of allocation of resources obviously preclude the existence of a capital market, and commercial credits granted in some cases by individual enterprises are entirely dependent upon the decision of the central authorities. With minor exceptions, the foreign loans of the centrally planned economies are extended to the governments of the recipient countries, negotiations being initiated by either party through diplomatic channels. The credits are as a rule utilized within the public sector. Although the final agreements specify both the amounts of credit and the project for which they are earmarked, it is not known whether the initial proposals are presented in physical terms or in the form of a global sum of money which in the later stages is translated into specific quantities of various goods to be delivered to the recipient country. Since the utilization of credits always takes the form of shipments of specific goods from the donor country, it is obvious that the volume of credits offered by the centrally planned economies depends not only on their willingness to allocate a certain part of their savings to the recipient country but also on their capacity to deliver the required goods. In any event, even if the preliminary proposals are formulated in physical terms, they are necessarily influenced even at the initial stages by some broad indications of the total amount of loans which can be secured at a given period. Such global indications are particularly necessary in cases where the donor country agrees to finance an industrialization programme involving a number of projects. Thus, for instance, the Soviet industrialization loan of $117 million extended to the United Arab Republic in 1958 included financing of geological works and oil exploration and construction of plants in metallurgical, electrical, chemical and pharmaceutical industries as well as in food, textile and other light industries. In such cases, preliminary proposals including a list of projects or of commodities are subject to considerable revision in the light of information concerning the total value of available credits and the ability of the donor country to provide the specific commodities. Such information may be offered to the recipient country at the stage of informal exploratory discussions between the parties concerned. As a rule, the preliminary discussions relating to aid are referred to the central authorities which call upon various government departments or agencies for the general evaluation of the economic implications of the credits. The findings of these agencies provide the general basis for government decisions with respect to the granting of loans, preceding the formal conclusion of the general agreement with the recipient country. More detailed contracts are drawn up within the framework of the general agreement laying down in greater detail the sequence of construction and deliveries of goods and the preparation of projects and surveys as well as the details concerning technical assistance.

An important feature of these arrangements is the fact that the creditor country assumes full responsibility for the practical implementation of the aid programme. This is quite different from the method of operation frequently applied by other countries, where the creditor limits itself to supplying the finance, leaving to the recipient country the responsibility for actual construction and operation of the project. In the case of the centrally planned economies, the creditor country engages itself as a rule to provide the recipient country with a completed project ready for operation. This includes technical assistance, which is offered as an integral part of the project financing. In consequence, the recipient country does not enter into direct commercial relations with the enterprises producing goods or providing services for the project receiving aid, although such contracts or consultations are not precluded. The need for such direct relation is not of primary importance in the case of complete projects, however, because in any event prices, specifications and all technical aspects of project execution are prearranged through close co-operation between the agency of the creditor country responsible for the project and the corresponding organization in the recipient country.

[13] *See* Organisation for Economic Co-operation and Development, *Development Assistance Efforts and Policies, 1965 Review, Report of the Chairman of the Development Assistance Committee* (Paris, 1965).

IMPACT OF AID ON CENTRALLY PLANNED ECONOMIES

In view of the full utilization of resources which prevails in the centrally planned economies, the shipments of goods associated with long-term credits reduce the supply of commodities available for domestic uses and therefore may have a certain decelerating effect on the rate of economic expansion. This effect can hardly be evaluated without a detailed analysis of the degree of scarcity of specific commodities diverted from domestic use in connexion with foreign aid. In the absence of such information, certain conclusions can be derived from comparisons of the aid commitments with such aggregates as national income, investment and foreign trade. The credit commitments of the centrally planned economies have represented only a small fraction of net material product of these countries, ranging from about one-tenth to three-fifths of one per cent in 1960-1964. Since the predominant part of credits is offered in the form of deliveries of machinery and equipment, the impact of aid may be more effectively measured by relating the aid to domestic investment in machinery and equipment. These ratios, shown in table IV-5 were calculated on the basis of very rough estimates of the value of domestic investment measured in prices used in foreign trade, and therefore can be considered only as broad approximations of the actual relationships. They indicate that in 1960-1964 the credit commitments of the centrally planned economies to developing countries may have been as much as 5 per cent of investment in machinery and equipment in Hungary, over 3 per cent in Czechoslovakia and Poland, and about 2 per cent in the Soviet Union. In Bulgaria and in Eastern Germany, the corresponding figures amount to about one per cent. It should be remembered, however, that several of these countries extended considerable loans to or received loans from other centrally planned economies. Among countries for which data on loans as well as on investments were available, only Czechoslovakia, Hungary and the Soviet Union were not receiving any loans in 1960-1964. The value of all loans granted by these countries[14] in relation to investments in machinery and equipment was as high as 3 per cent for the Soviet Union, 5 per cent for Czechoslovakia and 6 per cent for Hungary.

While the reliability of these estimates is limited by the uncertainty concerning the relation between domestic and foreign prices, no such limitation exists with respect to comparisons of aid with foreign trade, which are both expressed in the same prices. The comparison of aid with trade is particularly significant because of the balance of payments problems of the centrally planned economies and in view of the great interest devoted recently to the effect of aid on the over-all growth of trade. The information on aid commitments in relation to exports in the centrally planned economies shown in table IV-6 indicates that in 1960-1964 the ratio of aid to trade ranged from 19 per cent in Bulgaria to 67 per cent in Romania. The aggregate ratio for the centrally planned economies other than the Soviet Union amounted to 37 per cent, and the average for all countries of this group to 42 per cent. The ratio of aid to exports to countries receiving credits was obviously much greater, amounting to as much as 86 per cent in 1960-1964.

Extension of credit to developing countries had a considerable impact on the expansion of trade. Between 1955 and 1964, exports of the centrally planned economies to developing countries rose more than three times and imports by almost three times. The expansion of trade with countries receiving aid was faster than that with other developing countries. Exports to these countries increased five times, imports about 2.9 times, total trade 3.7 times. Their share in total trade of the centrally planned economies with all developing countries rose from 44 per cent in 1955 to 54 per cent in 1964.

Table IV-5. Credit commitments in relation to investment in machinery and equipment, 1960-1964[a]

(Percentage)

Country	Credits allocated to: Developing countries	Credits allocated to: Developing and centrally planned countries
Bulgaria	1.55	2.03
Czechoslovakia	3.78	5.41
Eastern Germany	0.78	1.23
Hungary	5.32	6.13
Poland	3.16	3.56
USSR	1.81	3.19

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on table IV-1; *World Economic Survey, 1961* (Sales No.: 62.II.C.1), and national statistical yearbooks.

[a] In order to calculate these ratios, data on investment in machinery and equipment expressed in domestic prices had to be converted into prices comparable to foreign trade prices used in the evaluation of credit commitments. The conversion factors used for these estimates were derived from data on output of machine building industries in domestic prices and an estimated value of this output in roubles, in 1960. The latter series was calculated by the use of estimates of relative value of output of these industries in various centrally planned economies expressed in comparable prices, as indicated in *World Economic Survey, 1961*, p. 106. The value of investment in machinery and equipment in roubles was converted into dollars at the rate of $1 = 0.6 rouble, based on the estimate in A. I. Kats, *Proizvoditelnost Truda v SSSR i Glavnykh Kapitalisticheskikh Stranakh* (Moscow, 1964), p. 57. The ratios indicated in the table can be considered only as broad approximations.

[14] Including those extended to other centrally planned economies.

Table IV-6. Centrally planned economies: Credit commitments in relation to exports to developing countries, 1960-1964

(Percentage)

Country	Credit commitments in relation to exports to	
	All developing countries	*Credit receiving countries*
Bulgaria	19 1	58 2
China (mainland)	26 0	109 0
Czechoslovakia	34 5	78 1
Eastern Germany	35 2	72 8
Hungary	58 4	100 7
Poland	50 9	91 7
Romania	66 6	139 1
Total, above countries	37 2	94 1
USSR	52 1	79 5
Total	42 3	86 0

Source: Table IV-1; International Monetary Fund, *Direction of Trade, Annual 1960-64* (Washington, D.C.), and national statistical yearbooks.

But while this trend was apparent in the development of the aggregate trade of the centrally planned economies with developing countries, the reverse was true with respect to the trade of several countries taken individually. Thus, as may be seen from table IV-7, during 1955-1964 five out of eight countries increased their total trade with developing countries about as fast as or faster than their trade with countries to which they had extended long-term development loans. These differences were much more pronounced during the second half than during the first half of the period. Although exports were obviously more directly influenced by aid, the data relating to the growth of exports also indicate that the trade of several centrally planned economies with credit receiving countries rose more slowly than that with other developing countries. Moreover, no systematic relationship is evident between the volume of aid in relation to trade and the rates of growth of trade between individual centrally planned economies and credit recipient countries. This is clearly visible if one compares the ranking of the centrally planned economies according to the aid to trade ratios and their ranking according to the rates of growth of trade.

The relations between these aggregates may be influenced of course by the relative magnitudes of trade with individual countries as well as by the timing of credit commitments. Thus, for instance, a higher percentage growth of trade would naturally be expected in cases where the initial volume of trade was smaller than in cases where the trade was quite substantial in the beginning of a given period. The effect of aid on trade in a given time span would also largely depend on whether the aid was granted in the beginning of the period or at the end. But a more detailed analysis of changes in the trade between individual countries and its relation to aid confirms the conclusions presented above.

Table IV-7. Centrally planned economies: Relationship between aid and growth of trade, 1955-1964

(Percentage)

Country	Aid in relation to trade with recipient countries[a]	Rate of growth of trade[b]	
		With recipient countries	*With all developing countries*
USSR	59 7	25 3	20 2
Romania	51 5	10 4	12 9
China (mainland)	37 5	17 1	11.3
Czechoslovakia	34 1	4 5	4 6
Poland	33 0	6 9	11 0
Eastern Germany	29 3	15 5	17 6
Hungary	27 7	8 1	8 4
Bulgaria	23 4	51 4	39 1
Total	47 0	15 7	13 3

Source: Table IV-1, and national statistical yearbooks

[a] Commitments in relation to exports plus imports

[b] Annual compounded averages.

FUTURE EXPANSION OF AID

The future expansion of aid extended by the centrally planned economies to developing countries will obviously be influenced among other factors by the growth of their output, and even more by the expansion of their foreign trade.

The implication for the centrally planned economies of the General Assembly and UNCTAD recommendations concerning the allocation of one per cent of national income of the donor countries as aid to the developing countries may be assessed by comparing the loan commitments of the centrally planned countries in 1960-1964 with the amounts corresponding to one per cent of the gross national product of these countries,[15] and by relating these amounts to the exports of the centrally planned economies to developing countries during the same period. The estimates given in table IV-8 indicate that the application of the one per cent assessment would imply a rise of total loan commitments of the seven centrally planned economies listed in the table from about $0.6 billion *per annum* in 1960-1964 to $3.1 billion. Needless to say, in terms of actual aid flows to developing countries the percentage increase would be greater.

Although further growth in the aid to developing countries is anticipated by the centrally planned economies, it has been frequently stated that in evaluating the possibilities for such further growth the fact should not be disregarded that many of the

[15] According to the United Nations' interpretation, the one per cent is to be applied to gross national product at market prices.

Table IV-8. Centrally planned economies: Actual commitments and hypothetical commitments of one per cent of gross national product, 1960-1964

(Millions of dollars)

Country	*Actual commitments*	*Estimated one per cent of GNP*[a]	*Exports to developing countries*
Bulgaria	26	233	136
Czechoslovakia	400	818	1,159
Eastern Germany	144	1,143	409
Hungary	170	350	291
Poland	336	1,043	660
Romania	170	554	255
USSR	1,951	11,263	3,745
Total	3,197	15,403	6,655
China (mainland)	603		2,322

Source: Centre for Development Planning, Projections and Policies of the United Nations Secretariat, based on table IV-1; *World Economic Survey, 1964, Part II* (Sales No: 65 II.C.2), and national statistical yearbooks.

[a] Gross national product was estimated by adding depreciations and the value of non-productive services to the net material product The value of non-productive services was calculated under the assumption that its ratio to net material product is equal to the ratio of labour employed in the non-productive sectors to total labour force The data in domestic prices were converted into roubles by the use of estimates of relative value of net material product of various centrally planned economies expressed in comparable prices (See *World Economic Survey, 1964, Part II*, p. 187) The data in roubles were converted into dollars at the official exchange rate of $1 = 0 90 rouble.

centrally planned countries are in fact receiving considerable credits from other countries, and that the total credits extended by those of the centrally planned countries which are not receiving any aid exceeds substantially their commitments to developing countries.

The available information on the total aid given and received by the centrally planned economies (*see* table IV-9) indicates that in 1955-1959 all countries excepting the USSR and Czechoslovakia were net debtor countries and that the total aid received by them from other centrally planned economies substantially exceeded the aid extended by them to developing countries. The aid extended by the Soviet Union to developing countries amounted to about 57 per cent of the aid of that country to the other centrally planned economies. During 1960-1964, only Bulgaria, Eastern Germany and Poland were net debtor countries in their relations with other centrally planned economies. In the case of Poland, the credit commitments to developing countries substantially exceeded the net aid received from the centrally planned economies, and in the case of Eastern Germany they amounted to over three-fifths of the net aid received. In all countries, the volume of credits offered to developing countries was much greater than that extended to the centrally planned economies

Table IV-9. Credits granted and received by the centrally planned economies, 1955-1964[a]

(Millions of dollars)

Country	*1955-1959*				*1960-1964*			
	To and from the centrally planned economies			*To developing countries*	*To and from the centrally planned economies*			*To developing countries*
	Granted[b]	*Received*	*Net*		*Granted*[b]	*Received*	*Net*	
Bulgaria	—	230	—230	—	8	495	—487	26
China (mainland)	904	1,428	—524	155	497	40	457	603
Czechoslovakia	333	13	320	201	173	—	173	400
Eastern Germany	292	542	—250	35	84	311	—227	144
Hungary	8	364	—356	6	26	—	26	169
Poland[c]	8	683	—675	51	43	189	—146	343
Romania	8	298	—290	12	52	—	52	170
USSR	3,173	—	3,173	1 793	1,491	—	1,491	1,921

Source: *World Economic Survey, 1960* (Sales No.: 61 II.C.1). p 120; *Dengi i Kredit*, No. 9, 1961; Nos 3 and 6, 1962; S D. Sergeev, *Ekonomicheskoe Sotrudnichestvo i Vzaimopomoshch Sotsialisticheskikh Stran* (Moscow, 1964).

[a] Data refer only to the amounts of credits and grants reported in special announcements referring to specific countries; they may differ from the actual totals of aid received or extended. According to the last source quoted above, the total aid extended by the Soviet Union to all centrally planned economies up to 1964 amounted to about $9 billion

[b] Including credits extended to centrally planned economies not listed in the table.

[c] In addition to the aid received from the centrally planned economies, Poland also received from the United States in 1957-1964 grants in surplus agricultural commodities equivalent to $41 4 million and a $10 4 million grant for construction of a children's hospital, of which $2 2 million was for actual cost of United States equipment and $8 2 million represented the value of Polish zlotys derived from sales of Public Law 480 Title I agricultural commodities The total sales of commodities amounted during the period to $553 7 million. The proceeds of these sales in zlotys are reserved for United States expenses in Poland, with any unused balances after ten years to be repayed in equal annual instalments over a thirty-year period. This provision was not applied fully to the $60 million sales of surplus commodities (included in the figure quoted above) during the United States fiscal year 1964; of this, $30 million is to be repaid in dollars over a three-year period. In addition, Poland also received a total of $61 million in loans during 1957-1959, repayable in dollars in twenty-five years, including a five-year grace period with annual interest rate of 4 5 per cent

New tendencies in the aid policies of the centrally planned economies

As already stated, the centrally planned economies provide almost all their economic aid in the form of credits, while grants account for only a small proportion of the total. The official justification for this form of aid is that credits represent arrangements beneficial to both contracting parties and therefore provide a more solid and adequate basis than do grants for full equality of the partners and for mutually satisfactory long-term arrangements.

Needless to say, the aid extended by the centrally planned economies to the developing countries has also been influenced, as in other countries, by political and other considerations. These considerations, according to official statements, have not been confined to current policy problems. Aid policy is envisaged within a broader perspective of historical change which, according to this view, creates a basic community of interest between the developing countries and the centrally planned economies. Thus, it is maintained that the industrialization of the developing countries, resulting in their increasing economic independence from colonial powers and other developed market economies, is an important factor in strengthening the position of the group of centrally planned economies in the world economy. Moreover, it is believed that the process of economic development in these countries raises structural and other problems that cannot be solved without the extension of the state sector and of economic planning. In consequence, foreign aid, fostering economic growth, leads these countries, without any conditions imposed from the outside, to adopt methods and policies which bring them closer to the centrally planned economies.

It is believed that this general tendency inherent in the economic growth of developing countries may be considerably weakened if the conditions of providing aid are such as to prevent the growth of the state sector, reduce the scope of planning and increase the dependence of these countries on the developed market economies. In the light of these considerations, the aid of the centrally planned economies has been almost exclusively limited to the state sector and largely concentrated on manufacturing projects, and more specifically on heavy industries which are regarded as essential for lessening the dependence of the developing countries on developed countries.

The economic benefits of the developing countries from the aid received are self-evident. The case is less clear with respect to the economic benefits derived by the centrally planned economies from these policies. In fact, it is doubtful whether the principle of "mutual benefits", which is supposed to underlie the aid policy, can be interpreted as referring fully to economic benefits so far as the centrally planned economies are concerned. The decisions concerning the volume and the geographical and sectoral allocation of aid were obviously not influenced by the profit motive. The low interest rate was, according to official sources, barely sufficient to cover the expenses of the organization entrusted with preparation and implementation of the aid programmes.[16] It is equally obvious that the extension of aid could not, in the conditions prevailing in the centrally planned economies, have any stimulating effect on the growth of the economy through the multiplier effects of additional foreign demand. In fact, none of the centrally planned economies has ever suffered from a deficiency of effective demand; on the contrary, all the factors which have limited their growth have always been on the supply side. In view of the particularly high level of demand for investment goods, the shipment of these goods as aid to the developing countries reduces the supply of scarce resources which would otherwise be available for domestic investment, and, therefore, has a certain decelerating effect on the rate of economic expansion.

The restraining effect of the supply factors on economic expansion is also shown by the serious difficulties that most of the centrally planned economies encounter in securing essential imports for lack of foreign exchange. Although it is difficult to say whether the goods shipped on credit to developing countries could in all cases be exchanged for the required imports, there is little doubt that some of them could be used for this purpose and that, in the longer run, the resources used for their production could be channelled into production of other export goods in high demand.

Another important issue with regard to the aid extended to developing countries concerns its effect on the aid given to the centrally planned economies by other countries of the group. Several centrally planned economies can certainly be considered as less developed, and facing problems in many respects similar to those of developing countries in the rest of the world. Most of these countries were receiving credits from other countries of the group, in some cases substantially exceeding the credits extended by them to developing countries. But the growth of credits extended to developing countries has imposed considerable restriction on the aid that could be given to the credit receiving centrally planned economies.

[16] G. M. Prokhorov, op. cit., pp. 131-132.

To stress the importance of these problems is not to deny the purely economic advantages which have offset, at least to some extent, the high opportunity cost of the aid extended by the centrally planned economies to developing countries. It has been repeatedly stressed in the centrally planned economies that among the purely economic motivations of aid was the desire to promote expansion of foreign trade and to secure higher imports from the credit receiving countries in the future. The extension of long-term credits is expected to create a favourable environment for expansion of trade over and above their direct effects. The construction of enterprises and the delivery of machinery and equipment on credit creates a market for replacement parts and stimulates further purchases of investment and other manufactured goods in cash or on commercial credit. Similarly the repayment of credits will finance a return flow of imports in the future. The development of such bilateral flows increases the possibility of expanding imports without a commensurate increase in payments in convertible currency. The exchange of machinery and equipment and especially of complete installations against raw materials and consumer goods could not be achieved on a cash basis, and the extension of trade according to such patterns would, in any event, require at least commercial credits.

Although these purely economic factors did play a part in determining aid policy, especially in the case of the smaller centrally planned economies, they do not seem to have been of primary importance for the larger proportion of loans granted by the centrally planned economies to developing countries. Thus, a highly authoritative statement emphasizing the determination of the centrally planned economies to aid the developing countries in their striving towards industrialization and economic and political independence included the comment that "obviously, one cannot say that in this case our economic relations are based on mutual benefits. Broadly speaking, our economic and technical assistance to developing countries is rather disadvantageous to us from the commercial point of view".[17] According to another statement, "If one should approach this problem from such a purely commercial point of view then it would be more advantageous for the Soviet Union to build new plants in the country with these funds and to export finished goods. The Soviet people are far remote from such a purely commercial attitude in their relations with countries to which they extend economic assistance".[18]

More recently, increasing attention has been devoted in many centrally planned economies to the problem of economic assistance to developing countries and, in this context, the concept of "equal mutual benefits" has also been subjected to closer scrutiny. As indicated above, this concept, which has been considered as the basic principle of the policy of co-operation with developing countries, did not in fact have any precise economic content.

The increased interest in this aspect of the problem of aid was in part influenced by certain developments affecting the economic growth of the centrally planned economies in recent times. Several of these countries have recently experienced a slowing down of the rates of their economic expansion. Among contributing factors, the most significant was a rise in capital-output ratios, the effect of which could not be easily compensated, in present conditions, by depressing the share of consumption in national income. Balance of payments problems also adversely affected growth rates.

Efforts to grapple with these problems and to improve over-all economic efficiency have led to a re-evaluation of past experience and to far-reaching reforms in the methods of planning and management of the economy. Needless to say, these efforts have not been confined to the domestic sectors only. The attempts to introduce more efficient methods and policies were not less significant in the field of foreign economic relations, including both trade and aid policies. It is true that no official announcement of any change in aid policy has so far been made by the Governments of the centrally planned economies. But the tendency towards a significant re-evaluation of these policies and the emergence of new approaches to the problems of economic assistance became apparent with the publication of a number of studies in several centrally planned economies.[19] Some of these views were also expressed in the proposals submitted by the centrally planned economies to the United Nations Conference on Trade and Development, and were reflected in some of the resolutions adopted by the Conference.[20]

NEW APPROACHES TO ECONOMIC ASSISTANCE

The re-evaluation of the aid policy reflected in these studies does not imply a reduction of the economic assistance extended by the centrally planned economies to developing countries. The studies are mostly concerned with the elaboration of policies opening new opportunities for international co-

[17] N. S. Khrushchev, *Pravda* (Moscow), 13 July 1958.

[18] Editorial in *Pravda*, 9 May 1958.

[19] *See*, for instance, *Gospodarka Planowa*, No. 12, 1963 (Warsaw); *Voprosy Ekonomiki*, Nos. 2 and 11, 1965 (Moscow); *Rudé Pravó* (Prague), 25 May 1965; *Kulkereskedelem*, No. 1, 1966 (Budapest); *Vnshna Trgovia*, No. 12, 1965 (Sofia).

[20] *See* United Nations, *Proceedings of the United Nations Conference on Trade and Development, Volume I, Final Act and Report* (Sales No.: 64.II.B.11), pp. 35-36 and *Volume V, Financing and Invisibles, Institutional Arrangements* (Sales No.: 64.II.B.15), pp. 358-359.

operation, based on a more realistic appraisal of the needs of the developing countries and of the capacities of the donor countries.

According to these views, the expanded contribution of the centrally planned economies for accelerating the growth of developing countries could not be sustained for long if the economic benefits derived from such co-operation were not mutual. This is particularly relevant with regard to the smaller centrally planned economies, and more specifically to the less developed countries of the group. It is believed that the equalization of economic benefits, far from reducing the actual advantages derived by the developing countries from their relations with the centrally planned economies, may in fact increase them considerably. This can be achieved by the introduction of new forms of co-operation between the centrally planned economies and the developing countries and by certain modifications in the credit policy of the centrally planned economies.

The suggestions put forward recently place the problem of long-term loans in a much broader framework of aid through extended economic co-operation of the two groups of countries based on mutual advantage. More explicitly, the allocation of aid, according to these suggestions, should not be treated in isolation but should be closely integrated and, in fact, subordinated to the expansion of trade between the centrally planned economies and the developing countries according to a pattern corresponding to the long-term interest of each of the contracting parties.

The increased emphasis on "aid through trade" is largely motivated by the belief that, in the longer view, the scarcity of foreign exchange is of more importance than the inability to increase domestic savings to the required levels in a large number of developing countries. The inability to exchange domestically produced commodities for investment goods which have to be secured from abroad is considered one of the main factors preventing potential savings from materializing or from taking the form of productive accumulation. Moreover, in spite of the effect of low levels of *per capita* income on savings, it is believed that in most of the developing countries there are untapped possibilities of raising internal accumulations through redistribution of national income by means of agrarian reform, appropriate taxation, expansion of the state sector, and other measures. This does not mean that the possibilities of raising domestic savings are sufficiently large to eliminate the need for foreign aid. But the most effective contribution of the centrally planned economies to the solution of these problems would be to help the developing countries to narrow the foreign exchange gap.

According to these views, it is far more important in the long run to create conditions which would enable the developing countries to increase their export earnings sufficiently to meet the gap than merely provide them with foreign loans. The possibility of a continual increase in foreign lending is obviously limited and the repayment of loans raises problems which cannot be solved without expansion of exports. The emphasis placed on expansion of trade is also motivated by the belief that this would necessarily lead to a more effective mobilization of national resources for economic development. Efforts aiming at expansion of trade and improvement of its pattern cannot be entirely successful if they are limited to the use of traditional methods of export promotion. Nor, according to these views, could the reduction of customs duties and other measures tending to improve the access of exports from developing countries to the markets of developed countries be expected to achieve much. The solution of the foreign trade problems of developing countries cannot be achieved without changes in the pattern of world production. It is further contended that the free play of domestic and international market forces would not, in the present conditions, lead to a change favourable to the developing countries. But considerable progress could be achieved by concerted action of several countries for changing the existing pattern of international division of labour. Such co-operation would have to take the form of long-term bilateral or multilateral agreements, aiming at simultaneous alteration of trade flows and of the structure of domestic production of the contracting parties.

It has been stressed that such agreements involving long-term decisions concerning domestic production and trade cannot be easily arranged by governments which have little control over production and trade. They are, however, particularly suitable for the centrally planned economies, which have announced their readiness to enter into this type of agreement with developing countries. The importance of such arrangements will obviously depend on the degree of planning and government control over production and trade in the developing countries. But certain arrangements of this kind, on a limited basis, are possible with government, semi-private or even private corporations in countries with little central planning.

The most significant feature of this new type of co-operation suggested by the centrally planned economies is that it goes beyond the usual trade agreements and that it extends into the sphere of productive activities of the interested parties. It does in fact imply the participation in one form or another of the developing countries in the planned development of international division of labour that is taking place among the centrally planned economies. This type of co-operation would, it is maintained, contribute significantly to the acceleration of growth of developing countries and provide at the same time important advantages to the centrally planned economies.

The impact of these considerations on foreign aid policies may be quite considerable. Although the development of the new type of co-operation is conceivable without foreign financing, it is believed that in most cases foreign aid will be required for the expansion of output earmarked for exports to the centrally planned economies. This would obviously call for a close integration of aid policies with the over-all co-operation policies. According to some views, the extension of aid, or at least of a significant proportion of aid, should be fully subordinated to the requirements of "productive co-operation", based on mutual advantage for the contracting parties. The allocation of credits on this basis would enable the centrally planned economies to sustain a much greater volume of aid than would be possible otherwise. But the application of these policies could have a considerable influence on the geographical and sectoral distribution of the long-term credits extended by the centrally planned economies to the developing countries.

It is of interest to note that the evolution of views concerning economic co-operation with developing countries is in some respects similar to the changes which occurred earlier in the relations among the centrally planned economies themselves. In the initial stage, ending approximately in the mid-nineteen fifties, economic co-operation between these countries was largely confined to trade and aid agreements. In the subsequent period, the main emphasis was placed on co-operation at the production level on the basis of intercountry specialization agreements. A further intensification of these tendencies was reflected in the considerable efforts devoted to the integration of sectoral and over-all development plans of CMEA countries and to various forms of participation of several CMEA countries in common production ventures.

The scope of the contemplated co-ordination of economic activities with developing countries is obviously much narrower. Co-operation among the centrally planned economies was stimulated by political, social and institutional affinities. But even in their case the co-ordination of economic activities has evolved only gradually, encountering serious difficulties on the way which have slowed down its progress and restrained its scope.

The suggestions put forward by the centrally planned economies do not aim at over-all co-ordination of production and trade programmes of the co-operating developing and centrally planned countries. They are, at least at this stage, confined to various arrangements concerning output and trade of specific goods involving, in most cases, provision of credits to developing countries. According to these proposals, which were reflected in a special resolution of the United Nations Conference on Trade and Development, the most practical form of the "new type of international co-operation" would be that of "industrial branch agreements between the countries concerned based on partial division of labour aimed at promoting the existing and establishing new export industries in the developing countries".[21] These agreements, by their very nature, would have to be concluded on a long-term basis and they could be of a bilateral or multilateral character. They would be concluded between governments, trading organizations or production enterprises of the participating countries. The main purpose of the agreements would be the establishment of export industries in the developing countries, designed to create complementarity of economies and based on specialization and partial division of labour between contracting parties. The centrally planned economies would provide machinery and equipment on credit to be repaid by exports of raw materials and other commodities until the new enterprises are able to produce goods for export to the centrally planned economies. The export of goods produced by the enterprises built under the branch agreements would have to be continued after the repayment of credit. This provision is obviously essential for specialization arrangements which are likely to affect the production programmes of the interested parties. The centrally planned countries have indicated their readiness[22] to adapt their development plans so as to import a stated proportion of the output of industries built under these agreements. The agreements are to include provision for close co-operation in designing the product, improving the processes of production and the quality of products. The centrally planned economies are also prepared to assist the developing countries in the promotion of exports to third countries.

CRITERIA FOR ALLOCATION OF AID

A most significant feature of this new form of co-operation is that it involves a close integration of the aid, trade and investment policies of the centrally planned economies. Within this framework, a certain proportion of the aid extended to developing

[21] See *Proceedings of the United Nations Conference on Trade and Development, Volume I, Final Act and Report*, pp. 35-36.
[22] *Ibid.*

countries may in a sense be viewed as an alternative to domestic investment in a given branch of industry. According to the views expressed recently, the decisions concerning the allocation of aid should take into account the evaluations based on the same efficiency criteria as those used in the centrally planned economies for the choice between alternative investment projects producing identical goods.[23] Although some of the formulas used in these evaluations are quite elaborate, their application consists, in the final analysis, in comparing the unit cost of a given commodity produced by the alternative projects. A given project is chosen if the current cost plus imputed interest on capital is smaller than those in alternative projects.[24]

The application of these criteria to the allocation of credits within the framework of co-operation agreements would consist in comparing the cost of production of a given commodity in the donor country with the cost of securing it from the credit receiving country in repayment of loans. In view of the existing price and foreign exchange systems, no such comparison could be made directly. Although various indirect methods could be used for these evaluations, it is obvious that the real unit cost of goods secured in repayment of credits will be fully determined by the opportunity cost of resources diverted from domestic use for foreign loans and by the volume of goods received in repayment of principal and interest. The total cost to the lending country will be equal to the value of credits expressed in domestic prices, compounded at the rate corresponding to the normative coefficient of efficiency (that is, the imputed interest rate) prevailing in the donor country. The volume of goods received in repayment of a given credit expressed in foreign prices will depend on the foreign prices of the commodities used for repayment and the interest charge on the loan. According to a recent suggestion,[25] the comparison of the unit costs calculated in this fashion should enable the donor country to evaluate the relative advantages of the allocation of a certain amount of resources for domestic investment and for foreign lending.

No such calculations have been undertaken in the past. In cases where economic considerations played a part in the allocation of aid, they were largely confined to broad evaluation of import requirements for commodities and the ability of the credit receiving country to satisfy these requirements. But foreign lending was not viewed as an alternative to domestic investment, and the criteria of efficiency of investment were not applied to foreign aid. It is true that such calculations would be of doubtful value as long as the goods to be used in repayment and their prices were not fixed in advance. The long-term credit agreements concluded so far have had no provisions concerning the type of goods to be used for the repayment of loans. The utilization of the sums accruing to the lending country was not treated separately but, together with other commercial transactions, was subject to annual negotiations concerning the list of goods to be exchanged at current world prices. In such conditions, the lending country would be reluctant to forgo the expansion of output of certain commodities in favour of uncertain future imports, even if, at the initial period, the extension of credits might seem to be more advantageous than would domestic investment.

It is clear, therefore, that the use of the efficiency criteria for the evaluation of various industrial branch agreements presupposes long-term agreements which will not only specify the goods to be used for repayment but also their prices. These proposals represent a significant departure from the prevailing practice, whereby the trade between the centrally planned economies and developing countries is conducted on the basis of current world market prices.[26] Since a certain price stability is considered as essential for such agreements, prices should be fixed at a given level agreed upon by the contracting parties, or they could be allowed to fluctuate only within certain limits. The implied renouncement of short-term gains for one or another party to the agreement through price changes would, according to these views, be largely compensated by the benefits derived from the long-term co-operation. The striving towards price stability, considered as essential for these arrangements, does not preclude a revision of the original agreements if justified by technical progress, discovery of new

[23] See *Voprosy Ekonomiki*, No. 2, 1965, and *Gospodarka Planowa*, No 12, 1963.

[24] The formula used in these evaluations can be presented as follows: $C + Ir =$ minimum, where C stands for current outlays for the duration of the project, I for capital outlays and r for the "normative coefficient of efficiency" which plays the part of imputed interest rate. The formula is based on the assumption that the volume of output of all projects under comparison is identical. Data relating to projects differing in volume of output are adjusted so as to render them comparable. The total outlays divided by the volume of output correspond to the unit cost. The normative "coefficient of efficiency" is defined as the reciprocal of the normative recoupment period. The latter represents the maximum number of years during which the additional capital cost of a more capital-intensive project should be recouped by savings on current cost. In principle, the normative coefficient of efficiency should be set at the level inducing the optimum combination of capital and labour. For more details, see *World Economic Survey, 1961*, pp. 104-108.

[25] See *Voprosy Ekonomiki*, No. 2, 1965, pp. 74-77.

[26] Certain suggestions concerning the use of different prices in the trade with developing countries were, according to the prevailing view, not acceptable on the ground that this would have a detrimental effect on general economic progress. See, for instance, *Rudé Pravó*, 25 May 1965, and, for a different view, *Nuestra Industria* (Havana), October 1965.

raw materials deposits or other changes. Such revisions made by common agreement may involve certain compensations for the resulting disadvantages to a given country. Moreover, it is believed that the prices set in the original arrangements need not correspond in all cases to those prevailing on the world markets at the time of the conclusion of the agreement.

The level of these prices will obviously have a considerable effect on the efficiency calculations of the lending country. The preliminary evaluations may be based on the world prices for goods to be used for repayment at the time of the loan negotiations and on the given interest rate applied to these credits by the lending country. If at this level of prices and interest rate the granting of credits is less advantageous than is domestic investment, then the extension of credits would not be justified on purely economic grounds. But it is emphasized that a large proportion of aid to developing countries will continue to be extended irrespective of these efficiency evaluations.

An important feature of the suggested credit policy is that, following the practice used in co-operation agreements between the centrally planned economies, it is to be based on the principle of the participating countries sharing the advantages of international division of labour. Thus, it is suggested that, in cases where the efficiency evaluations based on given prices indicate considerable advantage for the lending country, this country be prepared to share its benefits with the developing country through reduction of prices of machinery and equipment delivered on credit, or through increase of prices paid for the goods required in repayment of loans, or in reduction of the interest rate. It has been also suggested that, in view of the high production cost during the early years of operation of the new enterprises, the centrally planned economies would be prepared to increase temporarily the prices paid for exports of the enterprises built under the co-operation agreement, and reduce the prices of machinery and equipment for these enterprises below the normal export prices of these goods sold outside of the co-operation agreement to the credit receiving country.

It is believed that the temporary reduction of the advantages to the lending countries caused by these additional incentives for productive co-operation would be largely compensated in the longer run by increased over-all productivity in countries participating in the agreement. This attitude reflects the view that the co-operation agreements should not be based on the traditional interpretation of comparative cost theories tending to perpetuate the existing division of labour but on a dynamic concept of long-term "profitability" aiming at the improvement of the structure of output and trade of all parties concerned.

It is important to note that the principle of sharing of advantages of co-operation should, according to these views, work both ways. Before concluding a given agreement, the developing country would obviously compare the relative advantages of such agreements with other alternatives such as construction of a given project with the help of domestic resources or foreign private or official loans, taking into account such factors as prospective export markets and prices and other conditions. It is believed that if the relative advantages derived by the developing countries from the co-operation agreements with the centrally planned economies exceed those which could be derived from other alternatives, some adjustments in the terms of credits and repayment might be called for in accordance with the principle of sharing of advantages. This may be particularly important when the cost of a given commodity produced in a centrally planned country is lower than the cost of securing it at given prices from the credit receiving countries in repayment of loans. It is obvious that in such conditions the conclusion of "productive co-operation" agreements would depend on the willingness of the credit receiving countries to accept lower prices for their exports or to offer other compensatory measures to the donor countries. It is believed that even in such cases the advantages derived by the developing countries from co-operation agreements concluded with the centrally planned economies may outweigh those offered by other alternatives, because the loans are self-liquidating, their repayment does not create any balance of payments problems and the new productive capacities have a guaranteed export market at stable prices.[27]

The improvement of credit conditions for the lending countries may take various forms. Since the lending country is not concerned with the compounded value of credits expressed in foreign currency but with the volume of goods received in repayment of the principal and interest, it is immaterial to them whether the desired amount of goods is influenced by prices or by interest rates. According to some suggestions, if need arises, the centrally planned economies should be entitled to higher interest rates in cases where the repayment of loans is to be effected in low-priority goods, especially in goods in low demand on the world markets.[28] But this is to be applied largely to usual loans rather than to loans associated with co-operation agreements. In the case of the latter, the

[27] It has been emphasized that this is particularly important in the case of primary commodities, the prices of which show a declining trend.

[28] See *Handel Zagraniczny*, No. 12, 1965 (Warsaw), p. 560.

readjustments necessary to meet the requirements of efficiency evaluation would be applied to prices rather than to interest rates because these agreements provide for the continuation of shipments on a purely commercial basis beyond the period of loan repayment.

IMPACT UPON DISTRIBUTION OF AID

As already mentioned, this new type of "productive co-operation" may influence the geographical and sectoral distribution of aid extended by the centrally planned economies to developing countries. In manufacturing industries, the allocation will be influenced by cost and quality of labour. In extractive industries, the quality and location of national resources may be more important.

It has to be stressed, in this context, that the allocation of credits is not to be determined exclusively on the basis of the relative advantages of domestic investment or foreign lending evaluated by the use of the efficiency criteria described above. Other economic, social and political considerations will continue to influence decisions relating to credits and co-operation schemes offered to developing countries, as they do in the case of the choice between domestic investment projects, or the co-operation agreements between the centrally planned economies themselves.[29]

Although productive co-operation is contemplated in manufacturing as well as in the extractive industries, it is believed that the early agreements might begin with co-operation in the development of the extractive industries and in related industrial projects. Thus, according to a preliminary survey of the Institute of the World Socialist System of the Academy of Sciences of the USSR, there is a great possibility for agreement between the CMEA and developing countries on co-operation in connexion with expansion of output of oil, iron ore, ferrous metals, cotton and other processed and semi-processed materials in developing countries for export to the centrally planned economies.[30] These materials are now mostly supplied to the other CMEA countries by the Soviet Union. In view of the high cost of expansion of output of these commodities in that country, the diversion of trade in these goods to the developing countries would enable the Soviet Union to improve the structure of its investments and trade by reducing the growth of output and exports of materials where productive efficiency of its investments is relatively low and expanding its investment in machinery and equipment and other manufactures.[31] The other centrally planned economies would be able to acquire raw materials at substantial savings. For the developing countries such arrangements would bring in new export markets for their products at stable prices.

It has been pointed out that even if the credits were extended for expansion in the primary sectors, they would have a considerable impact on industrialization of the developing countries. This is largely due to the fact that the credit extended for the expansion of this output would include projects in complementary industries. According to an example given in one of the studies dealing with these problems, a country interested in imports of cotton might provide the producing country with loans for the expansion of output for both domestic use and exports and covering related projects such as hydro-electric systems associated with irrigation works, fertilizer plants, plants producing agricultural machinery and, eventually, textile plants.[32]

The extension of the co-operation schemes to cover manufacturing industries is obviously more difficult to carry out than is the case with primary production. These difficulties would be relatively easy to overcome in industries directly engaged in processing raw materials and even in plants producing relatively simple component parts for use in the production of certain assemblies in the centrally planned economies. International specialization and co-operation within the more intricate branches of industry, such as engineering and chemicals, may not be possible without the introduction of much closer ties between the enterprises of the contracting parties than in the case of the agreements covering the primary products and directly related industries. The higher the degree of specialization and technological complexity the greater is the need for closer co-ordination of the activities of co-operating enterprises for keeping abreast of technical progress and for meeting the requirements of the more developed industry of the lending country.

In view of these difficulties, it is hardly conceivable that this type of co-operation could be developed without some kind of participation of the lending country in the operation of the enterprises built under the agreement. The difficulties encountered in the field of component specialization

[29] The use of efficiency criteria will, however, permit a more accurate assessment of the opportunity cost of foreign lending even in cases where the loans are to be extended on other grounds.

[30] See *Voprosy Ekonomiki*, No 2, 1965, p 78, and No. 11, 1965, p. 85.

[31] The costly expansion of production of raw materials in the Soviet Union is in part determined by the import requirements of the other centrally planned economies, which pay for it by shipments of machinery and equipment. In consequence, Soviet imports of machinery from these countries are twice as high as its exports. This pattern of trade is considered as highly unfavourable to the Soviet Union. See *Novoe Vremya*, No. 6, 1966 (Moscow), p. 5.

[32] See *Voprosy Ekonomiki*, No 2, 1965, p. 79.

can be illustrated by the rather disappointing results achieved within the CMEA. Although the difficulties were aggravated by the presence of various unfavourable circumstances, there is no doubt that the absence of adequate co-operation arrangements at the enterprise level was among the most important causes of the slow progress in this field.[33] Efforts aiming at the improvement of intra-branch co-operation among the centrally planned economies have led to the creation of a number of joint enterprises, and a further extension of this form of co-operation is considered most promising. Although the setting up of such ventures would be more difficult between countries with different economic systems, the recent developments in the relations between centrally planned economies and western European firms indicate that these difficulties can be overcome. The emergence of joint ventures of the centrally planned economies and western European countries, though limited in numbers, may provide important indications concerning the eventual developments of co-operation at the enterprise level between the centrally planned economies and developing countries.

THE PATTERNS AND FORMS OF CO-OPERATION AGREEMENTS IN MANUFACTURING

Various types of production agreements have been concluded in recent years between western firms and eastern European enterprises. The common feature of these joint ventures is that the eastern European partners agreed to produce certain goods according to the specifications of their western partners and to make available to them a certain proportion of output at agreed prices.[34] The contribution of the western firms consisted in providing product designs, technological know-how and international marketing channels. In some cases, the scope of participation of the western firms was much broader, ranging from delivery of component parts or semi-manufactured goods for further processing in eastern European plants to supply of machinery and equipment as well as technical and managerial skills.

It is not known what part was played by western credits in most of these arrangements. However, in several cases involving construction of new plants and extension of the capacity of existing plants as well as retooling and modernization of productive facilities required for the production of goods specified in the agreements, the delivery of machinery and equipment by the western firms was financed by credits to be repaid by shipments of goods produced by the joint ventures.

Most of the production agreements were of a rather loose kind, frequently taking the form of contracts concerning the production and delivery of goods for a given project and therefore not entailing the establishment of durable links between the interested firms. This form of co-operation was considered sufficient when the technical levels of the participating enterprises were about equal. But even in such cases the goods to be produced by the eastern European countries were to correspond to the specifications of the western partners, and the agreements often provided for the transmission of designs and technological data and even the supply of technical skills when necessary.[35] The provision of such services was much more significant in long-period agreements, although in some cases they mainly concerned production and delivery of specialized goods to be sold under a common trade mark.[36] In more intricate co-operation schemes, the contribution of the western firm includes, in addition to licensing, transfer of designs and technological data, also credit financing of machinery and equipment and various forms of participation in the technical operation and management of the joint venture.[37]

[33] See *World Economic Survey, 1964, Part II*, p. 186.

[34] It is not known whether the volume of goods to be acquired by the western partner is in all cases fixed by the agreements. Presumably in most cases the acquisition is, at least in part, optional, depending on the situation on the western markets.

[35] For example, agreements were reached between Austrian and Hungarian enterprises for the construction of electric power stations in India and Lebanon. The turbines and generators were delivered by Hungary while the Austrian enterprises delivered the boilers and the transportation and electrical equipment An Austrian enterprise concluded with a Czech foreign trade corporation an agreement on co-operaton between Austrian and Czech engineering plants in setting up joint ventures in third countries. The Austrian firm may act as subcontractor to the Czech firm delivering chemical and other plants to African and Asian countries (See *Valóság*, No. 2, 1965 (Budapest) and *Business Europe* (Geneva), 14 July 1965.

[36] Thus, a United States firm has signed an agreement with Škoda, one of the most important equipment manufacturers in Czechoslovakia, by which the latter will produce a line of specialized heavy equipment under a common trade mark. The equipment will be built to the specifications of the American firm, which will be the sole distributor in North America The agreement was originally signed for one year only but was later extended for a period of five years. (*Business Europe*, 14 July 1965, and *New York Times*, 17 April 1966) Similarly, a British firm has concluded an agreement with a Czech firm for the assembling and marketing of a continuous-process unit for the production of textiles, according to which each partner will provide specific equipment for the unit. Marketing and servicing within the CMEA area will be handled by the Czechoslovak trade organization while the British firm will have the exclusive right for sales in the rest of the world. (*Business Europe*, 9 December 1964.)

[37] According to information from Hungarian sources published in *Neue Zürcher Zeitung*, 23 January 1966, the Hungarian firm Csepel signed a joint venture agreement with a concern in the Federal Republic of Germany under which a plant producing machine tools is to be set up as part of the Csepel industrial complex in Budapest. The contribution of the German firm to this undertaking will consist in providing a loan equivalent to DM 50 million, specialized equipment and technical personnel It will presumably be compensated by receiving part of the plant's

Particularly important, from the point of view of both the eastern and the western participants to the agreements, are the marketing arrangements which in most cases give to the eastern countries exclusive rights for sales in the area of the centrally planned economies, leaving the western markets entirely to their western partners. While factory prices paid by the western partners are fixed by the agreements, the sale prices charged by these firms in the territory allocated to them are entirely under their jurisdiction.

It has been suggested that these forms of co-operation offer to the centrally planned economies some of the advantages of direct investment without its objectionable features. The advantages consist obviously in the fact that such ventures give the centrally planned economies access to the more advanced technology, management and technical skills of the western enterprises, and provide them with capital. Moreover, these arrangements open to them the western markets which they could hardly penetrate without the aid of their western partners. The risks involved in these ventures are also shared, at least in part, by the western partners.[38] But the enterprises participating in these schemes remain under the state ownership and control of countries in which they are located. Moreover, their western partners are not entitled to any direct participation in the profits of the enterprise.

From the point of view of western firms, the effect of these limitations may largely be compensated by the fact that the goods produced under the agreements are offered at very advantageous prices and that the profits from the sale of these goods by the western firms remain entirely at their disposal. Extensive co-operation in management and in supervision of production processes and quality control provides no less guarantee of efficient fulfilment of commitments than in the case of subsidiary enterprises. In consequence, the advantages of this form of co-operation are for the western firms in many ways similar to those of direct foreign investment.

The considerable interest displayed by the western firms in these arrangements was entirely due to the fact that they were able to secure certain goods at a much lower cost than they could have done at home. It is not an accident that most of the western firms involved in these arrangements are located in countries suffering from labour shortages which could not be alleviated without considerable expenses for obtaining foreign labour. The labour force in the eastern European countries includes a substantial proportion of highly skilled workers whose services can be made available for the joint ventures. Similarly, many technological achievements of the centrally planned economies in specialized fields would also be available to them.

It is of interest to note, in this context, that the traditional opposition to the direct participation of one country in the ownership of productive facilities located in the territory of another country is not as widespread as it was in the past. Even in the relations among the centrally planned economies, direct investment was opposed on the ground that it infringed upon the national sovereignty of the recipient country. In many instances the rigid interpretation of this principle was an important factor in hampering the establishment of joint undertakings. According to the views expressed recently, however, these fears concerning national interests are regarded as unjustified under the conditions prevailing in the centrally planned economies, and jointly owned enterprises are, in fact, being set up on the basis of equal participation in investment and in profits of two or more centrally planned economies.[39]

Attitudes towards arrangements involving the participation of western countries in joint ventures have also become much more flexible. There is an obvious tendency to play down the formal aspect of ownership and profit sharing in favour of a realistic evaluation of the advantages or disadvantages of specific forms of co-operation under given conditions.

According to some views, which are by no means universally accepted, the centrally planned economies should be prepared to accept sharing of capital and profits with western firms participating in joint ventures located in eastern Europe if this is necessary to ensure the most efficient forms of management, the use of the most modern techniques and the optimal use of productive capacity. Although acceptance of such "mixed corporations" is regarded as a transitory measure, it is emphasized that they cannot be set up on a short-term basis. The major shares of such undertakings should, according to these suggestions, belong to the socialist state. This provision, together with the fact that the jointly owned enterprises operate within the general economic and social framework of the centrally planned economies, is considered sufficient guarantee to eliminate the risk of negative effects of direct foreign investment.[40] It should be added that these views do not imply any change in the attitude towards direct

production. Another example is that of the agreement signed by Poland with a Swedish furniture store chain according to which the Swedish firm is to provide its Polish partner with machinery and designs for the production, under Swedish technical control, of semi-manufactures to be shipped to Sweden for final processing. Several other agreements of a similar type have been negotiated, and in some cases signed, by the centrally planned economies with various western firms.

38 The benefits derived by the western partners depend largely on the prices and volume of their sales on the western markets and therefore are subject to the fluctuations of demand on these markets.

39 See *Novoe Vremya*, No. 6, 1966, p. 5.

40 See, in particular, *Valóság*, No. 2, 1965, pp. 31-38.

investment in developing countries. It is, in fact, believed that the relatively small size of the state sector and the limited scope of central planning and government control prevent the developing countries from avoiding the adverse effects of direct investment on the pattern of economic development and, more specifically, on the balance of payments situation.

In the conditions prevailing in the centrally planned economies, however, the difference between participation in ownership and profit sharing and other forms of co-operation in joint ventures described above becomes for all practical purposes a matter of purely legalistic distinctions without much economic content. For example, when the western partner acquires the product of the common venture at cost or at prices substantially below the sales price on the western market, this is tantamount to a *sui generis* participation in profits, which in any event could be repatriated only in the form of commodity exports. The secondary importance of these distinctions from the economic standpoint is recognized even in pronouncements against the granting to western firms of any ownership rights in the undertakings located in the territory of the centrally planned economies. According to a recent statement directed against attempts by some firms in the Federal Republic of Germany to acquire such rights, it was pointed out that "the creation of 'enclaves', 'islands' of capitalist property in the territory of socialist countries will, incidentally, provide the economies of capitalist states with little or no additional advantage as compared to the advantages obtained on the basis of industrial co-operation agreements. The creation of such 'enclaves' is contrary to the principles of the socialist system and would arouse popular discontent".[41]

This rather lengthy digression concerning co-operation agreements between the eastern European economies and western countries indicates the possible pattern of development of co-operation between the centrally planned economies and the developing countries in the field of manufacturing. The need for closer ties between co-operating enterprises, especially in cases where the co-operating countries differ substantially in respect to levels of technical and managerial achievements, seems to be even more important in the relations between developing countries and the centrally planned economies than in the relations between the latter and the developed market economies. It is, therefore, most likely that development financing in manufacturing will be closely associated with setting up of joint ventures of the type described above. The eventual participation of the centrally planned economies in technical operations and in management of the joint ventures located in the territory of the credit receiving country is not to be associated with any participation in the ownership and profits of these enterprises which, according to the prevailing views, should in all cases be fully owned by the developing country.

Although translation of the new approaches to co-operation and development financing into policy measures is still in the preliminary stages, the possibility of such agreements in various fields has been explored in several centrally planned economies. The only known agreement already signed is that concluded in 1966 between Poland and India concerning industrial and technical co-operation in the shipbuilding and chemical industries as well as in production of certain types of machinery and equipment.[42]

MULTILATERALIZATION, TIED AID AND PROJECT FINANCING

The development of the new forms of economic co-operation between the centrally planned economies and the developing countries, and the corresponding changes in credit policy, may also affect attitudes towards such problems as project financing, tying of aid and the multilateralization of aid.

The credits extended by the centrally planned economies were in most cases earmarked for specific projects or series of projects frequently linked with a given development plan of the receiving country. The preference for project financing was closely related to the fact that in the centrally planned economies virtually all resources are allocated to specific purposes and that the extension of loans is influenced by the availability of specific goods to be shipped to the receiving country on credit. In these conditions, the extension of loans on a global rather than on a project basis would obviously be limited.

Although some relaxation of this policy is not excluded, it seems that the emphasis placed on "productive co-operation" and the setting up of joint ventures will tend to reinforce the preference for project financing in the credit policy of the centrally planned economies.

The need for multilateralization of aid of the centrally planned economies was explicitly stated in some suggestions concerning the new forms of co-operation. According to these views, the partial inclusion of the developing countries in the international division of labour of the CMEA countries would raise problems which could not be solved on a purely bilateral basis. Their solution would require unification of efforts and co-ordination of activities of several centrally planned economies, *inter alia*, through the Council for Mutual Economic As-

[41] See *Problemy Mira i Sotsialisma*, No. 7, 1965 (Prague), p. 23

[42] See *Trybuna Ludu* (Warsaw), 2 April 1966.

sistance. Several centrally planned economies may be interested in expanding production of manufactured goods or in processing of raw materials in developing countries with a view to importing a certain proportion of the output of these industries. In such cases, the extension of credits for the expansion of these industries would be most effective for all concerned if it were done on a multilateral basis. The pooling of resources of several centrally planned economies for financing a given project would reduce the burden of credits for each lending country and would make possible the construction of projects which, in view of their cost, could not be financed on a bilateral basis. This is particularly true with respect to the smaller centrally planned economies. It has been suggested that the contribution of each centrally planned economy to total credits extended for a given project should be related to its share in the imports of the goods to be produced by the projects for all participating countries.

These suggestions concerning the pooling of resources of several centrally planned economies for financing a given project do not deal with other problems raised by the bilateral character of their credit arrangements. For example, these arrangements, like the tied loans of the developed market economies, oblige the recipient country to utilize the credits exclusively in the donor country for the purchase of specified goods and services. The restrictions imposed by this form of aid on the freedom of choice of the credit receiving country are well known. But these arrangements may also have a restraining effect on the volume of credits offered by any given country, by reducing it to the amount of goods which the donor country is able to deliver to the recipient country at any given time. Thus, a centrally planned country ready to offer credits to a developing country may not be able to secure the required goods, which may be more readily available in another centrally planned country, and may thus be inhibited from extending the credit. In a similar manner, the repayment of credits may create certain difficulties in cases where a given country has agreed to receive in payment goods which are not required at the time of repayment.

These problems may not arise to the same extent in the case of ventures financed jointly by several centrally planned economies and in cases where types of goods to be received from developing countries in repayment of loans are stipulated in the original agreements. But the credit agreements associated with the new type of productive co-operation are not likely to encompass in the near future more than a fraction of the total credits extended by the centrally planned economies to developing countries, and therefore will not solve the problems outlined above.

In certain cases, the problems arising from the strictly bilateral arrangements have been overcome by the use of facilities of the other centrally planned economies as subcontractors in production and delivery of certain goods unavailable in the donor country, and by re-export of goods received in repayment of loans where such goods were not required for domestic uses. But these arrangements have not been adequate to solve the problems arising from the strictly bilateral character of the aid agreements.

The shortcomings of this type of agreement are clearly recognized by the centrally planned countries, and the possibility of introducing a certain form of transferability of credits has been envisaged. The possibility of such an arrangement was mentioned some time ago in connexion with the creation of the "International Bank for Economic Co-operation" of the CMEA, and the introduction of transferable roubles and the multilateral compensation of payment balances among the CMEA countries, which, however, are intended to operate within the framework of bilateral agreements. Although these measures are to be applied only to CMEA countries at present, they open the possibility of a certain extension of these facilities to other countries. It has in fact been stated that the International Bank for Economic Co-operation may in future extend to developing countries credits in roubles convertible within the CMEA area; this would enable the receiving countries to use these credits for financing deliveries from any CMEA country on the basis of triangular or multilateral agreements. These facilities need not be limited to credits offered by the Bank, and may also be extended to credits offered by individual CMEA countries to developing countries within the framework of special agreements. The repayment of credits could also be effected by the use of transferable roubles earned from exports to another CMEA country rather than by direct exports of commodities to the donor country.

Little progress has so far been achieved in actual transferability of payment balances among the CMEA countries, and in no case was the use of these facilities offered to credit receiving developing countries. But the original designs have not been abandoned and further progress in this field is expected from the introduction of new measures opening the possibilities for conversion of a fraction of these balances into hard currencies. The willingness to extend some of these facilities to developing countries was recently reaffirmed in the official declaration of the CMEA countries presented to the United Nations Conference on Trade and Development, which stated that the countries with centrally planned economies are "prepared to arrange for gradually facilitating the transferability of credit balances between countries with centrally planned economies. It is understood that the desirability of such transfers is agreed upon between the partners concerned".[43] Although this statement was made in connexion with multilateralization of trade, it is obvious that it also applies to the utilization of loans. Moreover, as the trade between the centrally planned economies is conducted on a bilateral basis, such transfers will be subject in each case to the agreement of all countries concerned. This means that, at least in the initial stages, the credits granted by one country could not be utilized for purchases of goods in another country unless the centrally planned economies involved agreed on a bilateral basis about the type and amount of goods to be delivered by and to each of the participants to such agreements.

Although the introduction of partial transferability of credits would lessen the problems raised by the bilateral credit agreements, it is not likely to eliminate altogether the limitations inherent in tied loans regarding the choice of potential suppliers by the recipient countries. It has been maintained, however, in the centrally planned economies, that these effects are of little importance for the aid granted by these countries for the following reasons: the credit extended by them is as a rule formulated in physical terms and translated into value terms not on the basis of domestic cost but on the basis of world prices of specific commodities entering into a given project. In cases where world prices are difficult to determine, it is stated that the project under construction is offered on competitive terms with respect to prices, delivery and other relevant factors. This is made possible by the fact that, in the case of centrally planned economies, both the granting of loans and the execution of projects are undertaken by the State instead of being handled separately as in market economies.

According to some statements, a greater measure of convertibility, including the use of credits granted by the centrally planned economies for purchases outside the area, could not be achieved before a complete shift in the structure of world trade takes place. It is believed that the elimination of the trade barriers hampering the growth of east-west trade would result in an export surplus of the centrally planned countries in their trade with the developed market economies. This would provide the centrally planned economies with hard currency and therefore enable them to accept net imports from the developing countries and to extend part of their long-term credits in convertible currency rather than in kind.[44]

[43] See *Proceedings of the United Nations Conference on Trade and Development, Volume I, Final Act and Report*, p. 40.

[44] See *Zycie Gospodarcze* (Warsaw), 9 May 1965.

Chapter V

THE MULTILATERAL APPROACH TO DEVELOPMENT FINANCE

The present involvement of the international community in the financing of economic development had its origin in the Second World War but its growth is essentially a post-war phenomenon. Beginning with an emergency concern over problems of reconstruction, reparation of war damage, the settling of displaced persons and the supplying of the essential requirements of areas in which production had been severely disrupted, this involvement has extended and deepened steadily, ramifying to problems of greater complexity and longer-range implications than those dealt with in the earlier phase of relief and rehabilitation. It has widened in two distinct but interrelated ways, one dealing directly with the actual financial and physical transfer of resources and the other dealing with the less tangible but no less important questions of principles, national policies and international guide-lines. The former has meant the creation of a variety of institutions within which nations collaborate on transfer operations. The latter has meant a regular review of the global distribution of incomes, and a continuing debate on how higher-income countries might make available capital and knowledge to low-income countries and on the complementary problem of ensuring the most effective utilization by the recipient countries of the external resources so provided.

Though the forms and range of resources handled by international agencies have diversified and expanded very greatly over the past twenty years, the proportion of total transfers to the developing countries actually passing through such agencies has remained relatively small. During the first half of the nineteen sixties, less than 10 per cent of the resources provided by the more advanced countries was passed through multilateral channels. Such a figure, however, is by no means a measure of the influence of the international agencies on the nature and magnitude of the transfer: the experience of agencies in administering assistance programmes, the studies they have made of the process of economic development and of the need for and use of external resources, and the debates and recommendations they have stimulated have all contributed to shape the policies and practices governing the flow of capital to the developing countries, even when it moves bilaterally from exporter to importer.

Among the most significant developments in recent years has been the evolution of various means by which international thinking and action may be brought to bear most directly on national policies.

One such development has been the evolution of machinery—notably the "aid consortium" and the "consultative group"—which, though preserving the bilateral nature of the bulk of the flow of resources, exposes that flow to much greater international influence born of the experience of the sponsoring agency in dealing with both donor and recipient country and in reflecting a view of the latter's needs and performance that is comprehensive as well as expert. The successful operation of such machinery may serve simultaneously to mitigate not only the fears that recipient countries tend to have of the particular type of "strings" or conditions attaching —or believed to attach—to bilateral aid but also the fears that donor countries tend to have of possible waste or misapplication of the resources they provide.

Another such development has been the setting of targets for the outflow of resources from the more advanced countries. First applied in an aggregative fashion to all the more advanced countries combined, then singly to individual countries, such targets have more recently been proposed for particular components of the flow with a view to raising the proportion made available at low rates of interest and for lengthy periods of time. The acceptance of a target denominating the outflow of loans and grants as a proportion of the "national income" of the exporting country has a double significance. It reaffirms in a very tangible way the interdependence of the world economy and the recognition of the desirability of augmenting the flow of resources from the higher-income areas to the lower-income areas. It also builds into the objective itself a growth factor: the absolute level of the target rises with the increase in production in the higher-income areas.

In almost all the more advanced countries, governments have responded to the challenge thus laid down by the international community. In many governments, special departments have been established to deal with the administration of international development aid and technical co-operation. Though the rate of growth in official transfers of cash, commodities and skills slackened very noticeably after 1961, this was not because of any lack of awareness of the problem or of any organizational lacunae: acceptance of the international responsibility and existence of machinery for action have never been as widespread.

While arrangements for official transfers originated, and evolved to a surprising maturity, in the fifteen years after the war, international arrangements for harnessing more effectively the movement of private capital—on which the economic development of what was once regarded as the "new world" had hitherto almost exclusively depended—seemed to make relatively little progress. Quantitatively, the most significant effort was that of the International Bank for Reconstruction and Development (IBRD) in tapping the private capital market in a number of countries. On a much smaller scale, the International Finance Corporation (IFC) has channelled some private capital to individual enterprises in developing countries. In addition, one or two private efforts have been made on an international basis to sponsor increased direct investment in the developing countries—most notably by the ADELA Investment Company in the case of Latin America. And currently being discussed is a scheme, put forward to the first United Nations Conference on Trade and Development (UNCTAD) by the Governor of the Bank of Israel, for the creation of an international instrument to tap national capital markets and pass the proceeds on to developing countries at less than market rates.

There has also been a good deal of discussion of model investment codes to spell out in specific legal detail mutual responsibilities of foreign companies and host governments. In a more advanced stage of discussion is the possibility of multilateralizing the various systems of investment guarantees that have been evolving in individual capital exporting countries. And still more advanced is the debate on the narrower juridical question of arbitrating differences between host governments and foreign investors: this indeed has now reached the stage of a Convention—on the Settlement of Investment Disputes between States and Nationals of other States—which by February 1966 had been signed by thirty-three countries and ratified by four.

These debates, while concentrating largely on legal problems, have shown that the real stumbling blocks are generally of a more fundamental, economic and political nature. To improve the climate for private foreign investment in the developing countries, the process of reconciling both modalities and objectives has much further to go. Even within individual countries there are many areas and occasions when the interests of business and the interests of the community as a whole continue, actually or seemingly, to diverge. Such divergences are likely to be greater and more frequent when the business is foreign-owned. One problem lies in the differences in time horizon commonly adopted, and the process of reconciliation involves persuading the private investor to take a longer view and the host government to be more appreciative of the short-term difficulties that companies have to face. But the process of enlarging the area of identity of interests is always likely to be more complicated when two or more countries are involved. This remains a major subject for international exploration

The proliferation of international activities

Article 55 of the Charter enjoins the United Nations (and its specialized agencies) to "promote higher standards of living, full employment, and conditions of economic and social progress and development". And in pursuance of this the Economic and Social Council has from its very inception concerned itself with the flow of resources to the less developed parts of the world. One of its early resolutions—179 (VIII) adopted in 1949—called for a study of "methods of financing economic development of under-developed countries, including methods of stimulating the international flow of capital for this purpose, paying due attention to questions of a social nature which directly condition economic development".

This study[1] and much of the debate that followed during the next few years were concerned chiefly—at least as far as the international aspects of the problem were at issue—with the various difficulties that seemed to be inhibiting the movement of private capital to the developing countries. In the meantime, however, United Nations' interest shifted to the more practical problems of organizing and operating machinery for effecting the actual transfer of resources to the developing countries.

This interest was by no means new. Two years before the signing of the Charter, forty-four coun-

[1] United Nations, *Methods of Financing Economic Development in Under-developed Countries* (Sales No.: 1949. II.B.4).

tries had formally committed themselves to the United Nations Relief and Rehabilitation Administration (UNRRA), and between 1945 and 1947 almost $4 billion was spent by the agency in relief and rehabilitation. This period also saw the beginning of the United Nations' continuing involvement with the resettlement of refugees and the provision of basic material assistance to children. Begun in Europe, these activities expanded more and more into the less developed countries. This diversion of operations to the less developed countries also characterized the IBRD which, with the advent of the European Recovery Programme, soon completed the first of its functions (reconstruction) and transferred all its resources to the second (development), and this increasingly in the developing countries.

Alongside this concern with relief activities on the one hand and financial lending on the other came a growing involvement with the constellation of operations that became known as "technical assistance", which consisted in essence of the transfer of know-how and expertise to areas where their scarcity was a drag on development. Begun in a modest way as part of the regular United Nations budget, this was soon enlarged into a scheme which embraced all the specialized agencies and was financed by voluntary contributions of participating governments.

By the beginning of the nineteen fifties thus, the United Nations' system included a network of institutions and operations designed to transfer resources —money, food and knowledge—to aid in the process of development. It also had the capacity to organize special *ad hoc* bodies or programmes to deal with emergency needs such as those for relief, resettlement or rehabilitation flowing from the conflicts in Palestine (UNRWA) and Korea (UNKRA).

The second phase of institutional growth and innovation began in 1956. It was aimed more directly at the needs of the developing countries as these were then emerging, and it reflects the recognition of a series of specific gaps or requirements as well as a more general dissatisfaction with the rate of progress being attained in the developing countries.

The IFC, established as a subsidiary of the IBRD in 1956, represents an effort to stimulate both the process of industrialization and the movement of private capital to the developing countries. The United Nations Special Fund (UNSF) was a response to the complaint of lenders that there was often a lack of "bankable" projects in the developing countries, resulting in part from an ignorance of available real resources in the local economy and in part from the shortage of complementary factors with which to put capital usefully to work. The World Food Programme (WFP) reflects the serious imbalance in world agriculture and the failure of food production in many developing countries to keep pace with the growth of population now tending to accelerate. The regional development banks reflect the new interest in the possibilities of economic integration among individual countries and the emergence of various projects—most notably in the field of water development and communications—which need to be undertaken (and financed) on a multicountry basis. And the European Development Fund (EDF) and the International Development Association (IDA) mark the results of a realistic appraisal of the evolution of the debt-carrying capacity of many developing countries during recent years and in the immediately foreseeable future: they provide for grants or for long-term loans at a nominal rate of interest.

The need for "softer" loans has also been reflected in United Nations debates, culminating in 1960 in General Assembly resolution 1521 (XV) which decided, in principle, to establish a Capital Development Fund. A statute for such a Fund was subsequently drawn up, and following a recommendation —A.IV.8—of the UNCTAD in 1964, discussion is now focused on the possibility of extending the functions of the Special Fund to embrace investment financing as well as pre-investment activities.

The emergence of new needs in the developing countries has also influenced the activities and emphasis of established international agencies. The agricultural and educational lags have induced modifications in IBRD lending policies; weaknesses in public administration have given rise to special forms of technical assistance, including secondment of staff from abroad; the desire to improve the efficacy of economic planning has led the Special Fund to sponsor the establishment of a number of development institutes for training purposes. More recently, United Nations facilities to assist developing countries in their industrialization have been expanded by the setting up of an autonomous United Nations Organization for Industrial Development; this includes arrangements for Special Industrial Services financed by voluntary contributions of participating countries.

The growth of international agencies and the continual adaptation of their programmes have thus yielded a complex array of mechanisms through which resources can be transferred to the developing countries for the financing of development. The chronology of this institutional evolution is summarized in table V-1. Most types of resources can now be handled by these agencies and most of the means for effecting transfer between countries can now be employed by them. A more or less complete counterpart to bilateral transfers has been built up, and hence the option of using a multilateral agency is now open to capital exporting countries for most of their aid transactions with the developing countries.

Table V-1. International agencies through which resources are transferred to developing countries

Agency	Year of Establishment	Year of Operation	Principal activity	Average annual expenditure in recent years[a] (millions of dollars)	Source of funds[b]
United Nations Relief and Rehabilitation Administration	1943	1945 (to 1947)	Relief and rehabilitation in war-devastated areas	[c]	Voluntary contributions of 44 member governments; 73 per cent from United States
United Nations Children's Fund	1946	1947	Children's programmes in health, nutrition and education	27	Voluntary contributions of 121 governments plus private donations
United Nations High Commissioner for Refugees	1946	1947[d]	International protection of refugees and seeking permanent solutions to their problems	8	Regular United Nations budget plus voluntary government contributions and private donations
International Bank for Reconstruction and Development	1944	1946	Long-term lending to member governments at more or less market rates	260	Usable subscriptions from 102 members; sales of bank obligations; sales of portions of loans; repayments of principal; income from operations
International Monetary Fund	1944	1947	Short-term lending and monetary co-operation	124	Subscriptions by quotas of 102 members; plus funds negotiated under General Arrangements to Borrow
United Nations Relief and Works Agency for Palestine Refugees in the Near East	1948[e]	1950	Subsistence, shelter, education of persons displaced from Palestine	37	Voluntary contributions of 46 governments
United Nations Technical Assistance	1948	1949	Expert assistance, advice and training	12	Appropriation from regular United Nations budget
United Nations Expanded Programme of Technical Assistance	1949	1950	Expert assistance, advice and training from United Nations and 10 specialized agencies	40	Voluntary contributions of 108 governments

Table V-1. International agencies through which resources are transferred to developing countries (*continued*)

Agency	*Year of*		*Principal activity*	*Average annual expenditure in recent years*[a] *(millions of dollars)*	*Source of funds*[b]
	Estab-lishment	*Operation*			
Colombo Plan	1950	1950	Mutual aid in implementing national plans	[f]	Bilateral arrangements among 17 countries in southern and south-eastern Asia and 6 developed market economies outside the region
United Nations Korean Relief Agency	1950	1951 (to 1958)	Relief and rehabilitation in the Republic of Korea	[g]	Voluntary contributions of 39 governments
International Finance Corporation	1956	1956	Investment in manufacturing enterprises	11	Authorized paid-up capital of 78 members; sales of investments
European Development Fund	1958	1958	Grants and long-term low-interest loans to promote economic and social development of overseas states, departments and territories associated with European Economic Community (EEC)	55	Appropriations by EEC member governments[h]
United Nations Special Fund	1959	1959	Pre-investment surveys, technical assistance and training	37	Voluntary contributions of 106 participating governments
Inter-American Development Bank	1959	1960	Long-term loans to member governments and private enterprises in Latin America, mostly on commercial terms but also on easier terms and for repayment in borrower's currency	63	Authorized paid-in ordinary capital from United States and 19 Latin American Republics; contributions by member countries to fund for special operations; fund entrusted by United States Government to IDB; borrowing on capital markets; earnings on operations
International Development Association	1960	1960	Long-term low-interest loans	100	Subscriptions of 94 member governments; supplementary contributions; IBRD transfers

World Food Programme	1961	1963	Provision of food for development and relief purposes	17[i]	Voluntary contributions of 82 participating governments in cash, food and services
African Development Bank	1963	1966[j]	Long-term loans on commercial terms to member governments in Africa; "softer" lending through special funds	—	Paid-up capital from 27 regional members (50 per cent of authorized capital of $250 million)
Asian Development Bank	1965	1966[j]	Long-term loans on commercial terms to member governments in Asia; non-commercial loans are also contemplated	—	Paid-up capital of $1 billion of which about $650 million is to be contributed by 19 member countries from the region and $350 million by 12 non-regional members
United Nations Organization for Industrial Development	1966	1966	Technical assistance in the field of manufacturing	—	Partly from regular United Nations budget, partly from voluntary contributions of member countries

Source: United Nations, *Yearbook, 1964* (Sales No.: 65.I.1) *Everyman's United Nations*, seventh edition (Sales No.: 64.I.9); "Report on the World Food Programme by the Executive Director" (E/4043, 14 May 1965); "International Flow of Long-term Capital and Official Donations, 1961-1964" (E/4079/Rev.1); "Regional Development Financing", report by Henry S. Bloch to the United Nations Trade and Development Board (TD/B/AC.4/R.3) and *15 years and 150,000 Skills* (Sales No.: 65.I.18); International Monetary Fund, *International Financial Statistics* (Washington, D.C.), December 1965; International Monetary Fund, International Bank for Reconstruction and Development, International Development Association and International Finance Corporation, *Annual Reports* for the years 1964 and 1965; Union of International Associations, *Yearbook of International Organizations, 1964-1965*, tenth edition (Brussels, 1965).

[a] In or on behalf of developing countries, figures represent approximate net averages for the period 1961-1964.

[b] Based on 1964/65 budgets, except in the case of the United Nations Relief and Rehabilitation Administration and United Nations Korean Relief Agency.

[c] Average annual expenditure was over $1.8 billion. The bulk of this was spent in China, the Soviet Union and eastern and southern Europe. Among the developing countries, small amounts—about $12 million in 1946-1947—were spent in Ethiopia, Philippines and Republic of Korea.

[d] The International Refugee Organization took over the refugee work of the United Nations Relief and Rehabilitation Administration, and was liquidated at the end of 1951. An Office of the High Commissioner for Refugees was established in 1950. Its activities first concerned European refugees but were subsequently extended to refugees in other parts of the world, particularly Africa.

[e] Originally United Nations Relief for Palestine Refugees, which received $35 million from thirty-three governments in 1948. Its assets and responsibilities were taken over by the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) in 1950.

[f] The Colombo Plan does not dispense resources itself; it provides a co-ordinating mechanism for bilateral arrangements. Its central budget—for the Colombo Plan Bureau—has been of the order of $100,000 a year, divided equally among participating Governments.

[g] The equivalent of about $150 million was disbursed in the Republic of Korea during the period 1951-1958.

[h] 28 per cent each from Federal Republic of Germany, France and Italy, 7.9 per cent each from Belgium and the Netherlands and 0.2 per cent from Luxembourg.

[i] Rising sharply as programme gets under way.

[j] Expected.

The use of multilateral institutions

With the increase in the variety and size of the international agencies, the proportion of resources moving to the developing countries through them has tended to rise. The growth in the use of the agencies has been slower than might have been expected, however, and on a year-to-year basis the net flows into them and out of them have recently been characterized more by fluctuations than by expansion (*see* table V-2). These fluctuations reflect the creation of new institutions which draw funds into the international reservoir—from the developing countries as well as the more advanced countries—for some time before disbursements begin. They also reflect the incidence of institutional transactions—borrowing and repayment and the sale of portfolio obligations—on the capital market; this has been shaped not only by the need for funds but also by the state of the market in various developed market economies. And the ratio of multilateral flows to the total is also affected by the rather erratic swings in bilateral movements of private capital referred to in earlier chapters.

Table V-2. Role of the multilateral agencies in the transfer of resources to the developing countries,[a] 1956-1964

Year	*Net contribution to the agencies by the developed market economies*[b]				*Net flow of resources from the agencies to the developing countries*			
	Total (*Millions of dollars*)	*Public*	*Private*	*Percentage of total outflow*[c]	*Total* (*Millions of dollars*)	*United Nations*	*Other bodies*	*Percentage of total public flows*[d]
1956	193	167	26	4	229	90	139	8
1957	479	279	200	7	344	82	262	10
1958	679	238	441	10	392	80	312	10
1959	432	228	204	7	362	84	278	9
1960	775	590	185	11	290	105	185	7
1961	916	814	102	11	255	179	76	5
1962	875	645	230	12	414	157	257	8
1963	372	410	—38	5	638	199	440	11
1964	584	427	157	7	820	220	600	13

Source: See table II-1.

[a] The agencies included are: *United Nations*—United Nations Technical Assistance, United Nations Expanded Programme of Technical Assistance, United Nations Special Fund, United Nations Children's Fund, United Nations Relief and Works Agency for Palestine Refugees in the Near East, United Nations High Commissioner for Refugees, United Nations Fund for the Congo and World Food Programme; *other bodies*—International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Inter-American Development Bank and European Development Fund.

[b] Allowing for borrowing and repayment by the developed market economies themselves.

[c] From the developed market economies, public and private, bilateral and multilateral.

[d] From the developed market economies, bilaterally, and from the agencies, as reported by the source.

The net flow of resources into the agencies from the developed market economies reached a peak—of about $0.9 billion—in 1961, the year when capital was being subscribed to the International Development Association and the Inter-American Development Bank. As a proportion of total outflow from the developed market economies, it reached a peak—of about one-eighth—in 1962. Both figures have subsequently receded to the levels reached towards the end of the nineteen fifties. The net flow of resources from the agencies to the developing countries, after staying close to the $0.3 billion mark for a number of years, began to rise sharply in 1962. In 1963 the relative contribution of this flow to the total receipts of the developing countries (bilateral and multilateral) rose above the peak levels of the end of the nineteen fifties. It accounted for about one-eighth of the total in 1964 and probably a little more in 1965, but further advances in this ratio are contingent upon the replenishment of the agencies' resources. It is clear that in the immediate future the great bulk of transfers will continue to be effected directly between exporting and importing country.

The quantitive preponderance of bilateral flows is a reflection of the fact that the major suppliers of resources tend to have the most elaborate "foreign aid" administrations through which to effect transfers. Thus the proportion of official resource transfers passed through international agencies by France and the United States has been consistently below the average for all developed market economies and the multilateral contribution from the Federal Republic of Germany and the United Kingdom has slid down towards the average (*see* table V-3). In the

Table V-3. Developed market economies: Net official contributions to the multilateral agencies,[a] 1956-1964

Country	Average annual amount (millions of dollars)			Proportion of total official outflow of resources[b] (percentage)		
	1956-1958	1959-1961	1962-1964	1956-1958	1959-1961	1962-1964
Australia[c]	—7	27	5	d	33	6
Austria	—15	—8	3	d	d	43
Belgium	6	20	14	35	24	16
Canada	5	17	13	9	26	14
Denmark	4	2	5	100	67	83
France	19	59	66	2	7	7
Germany (Federal Republic)	127	167	45	55	45	11
Italy	—24	—14	8	d	d	12
Japan	—24	—49	—18	d	d	d
Netherlands	12	39	37	32	57	53
Norway	—	1	4	—	50	67
Portugal	—	3	—3	—	9	d
Sweden	5	7	22	83	88	76
Switzerland	16	4	5	100	80	71
United Kingdom	50	68	43	21	16	10
United States	63	199	232	4	8	7
Total[e]	228	544	492	7	12	9

Source: See table II-1.

[a] For definitions, *see* table II-1.

[b] From developed market economies to developing countries and mutilateral agencies.

[c] Average for fiscal years beginning 1 July of year indicated.

[d] Country was a net borrower from the agencies during this period.

[e] Countries listed plus Finland, New Zealand and South Africa.

case of many of the smaller sources much higher proportions have been channelled through the agencies—more than half of net official outflows from the Netherlands, Switzerland and the Scandinavian countries in recent years for example. In the case of the official outflows from the Federal Republic of Germany, Italy and Japan, reparation payments have tended to enlarge the bilateral component, but this influence is now diminishing. Where one of the smaller exporters of capital directs a high proportion of it bilaterally—as in the case of Australia and Portugal, for example—it has usually reflected the existence of special relations with particular developing countries or territories. Such special relations, usually the result of historical association, also help to account for the high proportion of bilateral transfers from Belgium as well as from France, the United Kingdom and the United States.

Apart from the existence of close institutional links with historically related countries, there are various other reasons why capital exporting countries may choose to build up an official organization for administering the transfer of resources to the developing countries and to operate on a bilateral basis rather than pass the resources in question to international agencies for distribution. Underlying most of them is the fact that during the post-war period the protracted debate on how to finance the process of development in the lower-income countries has been influenced not only by the actual economic and political evolution of those countries but also by all the considerations determining the external political and economic relations of the higher-income countries, including their relations with one another. These influences, always complicated and often conflicting, have interacted in a way that has induced, even impelled, each of the higher-income countries to hammer out a "foreign aid" policy. However tentative and changeable such a policy may be, its very existence entails assumptions and intentions in respect of the magnitude and distribution of resource outflows, both as to nature and destination. While it is possible, and perhaps even convenient, to bring the multilateral agencies into the picture as one of the destinations of flow—indeed, at the limit, a policy might consist of using the agencies for all the transfers in question—the higher the proportion so directed the more difficult it would become to pursue an effective independent policy in the disposition of the remainder. At bottom, therefore, the actual nature and content of a country's foreign aid policy are not really at issue in this context: it is the existence of a distribution policy which requires and explains the predominance of bilateralism.

This is not to say that the content of a foreign aid policy is not relevant to a discussion of the relative merits of bilateral and multilateral administration. On the contrary, for this purpose content is often crucial, as the relative effectiveness of the method of channelling the flow depends in part on its composition: in general, the more liquid the resource the more likely is it that its most productive use in promoting development can be achieved by an international agency. The difficulty in making a categorical judgement as to the advantages of international administration arises from the fact that the bundle of motives—political and humanitarian as well as economic—that determines national policy is subject to such frequent change that it becomes virtually impossible to generalize. At its best, bilateral aid is likely to be able to make the most effective use of the existing institutions and expertise that link the donor and recipient countries. At the other end of the spectrum, by contrast, donor policy may be motivated by a domestic commercial or strategic objective which has no relevance to the requirements of the recipient developing country and may in fact give rise to misallocation of the latter's resources. In between, in varying degree the bilateral administration of aid involves the application of criteria other than those of the development needs of the recipient country. And this dilution of the developmental purpose may not always be compensated for by greater volume or higher transfer efficiency.

Looking back over the post-war period, it is by no means certain that the total volume of resources transferred would have been as great as it has been if all flows had been administered multilaterally. Indeed, the presence of a political motive makes it almost certain that some countries will receive more in the way of external resources when these are administered bilaterally than they would do if the flow passed through some multilateral filter. An advantage deriving from determinants applied in a donor country may be ephemeral, however; it is likely to be affected by political changes—whether in the recipient country or in one or other of the more advanced countries—as well as by economic developments in the donor country, which may feel entitled to make sudden and significant adjustments in the size or composition of the flow.

Most probably it is the relative weight of this political motivation in bilateral transfers that leads the recipient developing countries, when faced with a choice, to prefer to obtain their resources from international institutions. This preference has been stated many times in the course of debates on the financing of economic development, and it is probably grounded in the sort of fear that induces a private borrower to seek accommodation from a large impersonal institution rather than from another individual, indebtedness to whom might be expected to generate a much greater sense of obligation. Though political determination is never likely to be wholly absent from multilateral flows, either, it tends to operate in a fashion less objectionable to most borrowers—by influencing the geographical or functional distribution of transactions, for example, rather than by making the transaction subject to some more or less tangible *quid pro quo* on the part of the recipient.

Not that transfers through international institutions are necessarily unconditional. Most of such transfers are contingent upon either a sharing of total costs by the recipient country or satisfactory performance in respect of utilization, sometimes upon both conditions. Enforcement may be more difficult for an international body than for a single capital exporting country, which is likely to have many more points and forms of contact with the recipient countries. Bilaterally, various pressures can be brought to bear on a debtor country that does not abide by the conditions laid down or perhaps implicit in the terms of transfer. And the donor country always holds the ultimate sanction of suspension or termination of the flow. On the other hand, multilateral lending agencies, whose resources may depend in some degree on their ability to borrow on the capital market, are not likely to prove unduly lenient creditors. The example set by the IBRD suggests that such agencies are fully capable of applying the strictest commercial standards to applications for loans as well as to their debtors' performance.

As indicated above, from the point of view of a developing country, a multilateral body with convertible currency at its disposal may offer wider choices in respect of the nature and origin of the resources to be transferred than are implicit in transactions with a particular country. Such a body should be in a position to provide a developing country with a wider range of capital goods and of expertise than might be made available by a single donor or lending country. Certainly, bilateral transfers are more susceptible to tying than are those that pass through an international agency. The difference is not a categorical one, however: on the one hand bilateral flows include many untied, convertible currency loans and grants, while on the other hand arrangements can be made to tie the funds placed at the disposal of some of the agencies, by blocking the currency involved, or by making its use subject to special consent. And some agencies—notably the WFP—actually deal with the transfer of resources in kind whose origin is from an economic standpoint presumably a matter of indifference.

Much more important from the point of view of the essential economic function the whole process of resource transfer is intended to serve is the capacity of the instrument involved, whether bilateral or multilateral, to take a sufficiently comprehensive view of the situation in the developing country. For the maximum benefit to ensue, the development policy of the recipient country must take precedence over the foreign aid policy of the country providing the resources. Priorities have to be set by the needs of the developing country rather than by export desires of the more advanced country. Within the framework of the development plan, the range of such needs is often very wide, embracing—at least in respect of the external component in each case—all the individual projects, all the single items of plant or equipment, all the producer goods, all the raw materials and components and all the consumer requirements, demand for which is likely to be generated by the process of investment. And over and above these specific needs, identifiable in advance, is a more general but sometimes crucial need for a sufficient amount of free foreign exchange to allow for contingencies arising from lapses in performance, failure to synchronize complementary elements, lags in delivery or shortfalls in domestic production of food or in any other essential input.

In purely physical terms, the required resources must move bilaterally from the country of origin to the country of use. It is the latter that determines need, in the light of development priorities. Financing the transaction is a separate problem and it is generally to the advantage of the developing country to be able to choose the goods or services it wishes to acquire quite independently of the means of payment. The availability of finance from an international source thus adds considerably to the capacity of a developing country to maximize the benefit derived from external resources.

In principle, however, there is no reason why the provision of the required physical resources and the necessary finance should not be equally well arranged bilaterally with various countries of supply, assuming always that the developing country is in a position to "shop around". For such bilateral arrangements to serve the purpose of the developing country in an optimal fashion is likely to call for firmness on the part of the planning and purchasing authorities and a certain degree of flexibility and sympathy on the part of the countries supplying the goods and the finance. For a single project, providing freedom to choose the lender is open, little advantage need be lost to the developing country in the course of bilateral negotiations. The difficulties of organizing external assistance on a bilateral basis are likely to expand rapidly, however, as the magnitude and complexity of total requirements rise. While small countries may be able to satisfy their needs by means of such bilateral arrangements—and, if they are in a position to "shop around," on a fully economical, competitive basis—larger countries may find it much more cumbersome. And when a country is concerned with the external financing of an articulated development plan extending over several years, the number and interdependence of its needs and even the sheer size of the total will greatly complicate the task of making external arrangements on a bilateral basis separately with many supplying countries. In these circumstances, moreover, the over-all requirements for external finance are likely to exceed the capacity of the international agencies as presently constituted. The problem facing countries trying to arrange the external financing of a development plan is less a choice between bilateral and multilateral assistance than one of negotiating and organizing the most effective combination.

This problem points up the need for another type of international machinery, concerned not with providing financial assistance so much as with co-ordinating such assistance. The question is: given the increasing tendency for developing countries to adopt more closely integrated forms of development planning, the continuing inadequacy of export earnings to finance the required inflow of resources and the continued predominance of bilateral flows of loans and grants, what type of international mechanism can best assure both the availability of the resources and their most effective utilization?

International machinery for mobilizing and co-ordinating the flow of development finance

Given the urgent need of most developing countries for additional external resources and given the multiplicity of types and sources of capital, there is evident scope for a mechanism for bringing together the various parties in a relationship which will facilitate both the flow of resources in their most appropriate form and their effective utilization in the development process. However, to recognize the desirability of such a mechanism in principle is a far cry from setting it up and operating it in practice. On the one hand, it necessarily involves a confrontation between two unequal protagonists—a client country and a group of potential suppliers of the needed resources. If the latter sit as an inquisition or even as a panel of creditors, the main purpose of the exercise will be defeated. On the other hand, such an occasion also involves a confrontation among the "creditors" themselves: filling a gap in foreign exchange supplies poses problems of "burden sharing" in an explicit, open and potentially uncomfortable manner. It is to be expected that a good deal of experimentation will be necessary in the evolution of satisfactory machinery.

THE HAGUE AND PARIS "CLUBS"

One of the early experiments relevant to, though not intended to deal specifically with, the problem as it is now posed, dates back to the mid-nineteen fifties, before the various currencies of western Europe were fully convertible. In order to establish a system of multilateral trade and payments relations with Brazil, a number of European countries came together in 1955 in what came to be known as the "Hague Club". And in the following year an essentially similar arrangement was initiated in respect of Argentina by a somewhat larger group assembled as the "Paris Club".[2]

In order to put the future system of financing trade with Argentina on a satisfactory basis, the creditor countries had first to make arrangements about past debts. The process of consolidating and rescheduling the debtor's external obligations was shaped as much in the interest of equity among the creditors as by the objective of re-establishing that country's credit for future imports. The arrangements made in 1957 for the repayment over the next ten years of about \$0.5 billion of Argentina's external debt became the model for subsequent similar exercises—with Argentina again in 1962 and 1965, with Brazil in 1961 and 1964 and with Chile in 1965.

These clubs have operated on an informal *ad hoc* basis, convening when necessary to deal with a debt repayment problem.[3] Several of the international institutions—the IMF, IBRD, IDB and OECD—have participated in their meetings, partly as observers and partly as advisers (the IMF on the current balance of payments situation of the debtor country, the IBRD on longer-term prospects). The IMF has also assisted in the refinancing operation by means of the parallel negotiation of a stand-by credit, and it has also undertaken responsibilities for reporting to creditor countries on certain matters of implementation by the debtor.

[2] The countries participating in the early activities of the Hague Club were Federal Republic of Germany, Netherlands and United Kingdom, later joined by Austria, Belgium, France, Italy and Luxembourg. The early members of the Paris Club were Austria, Belgium, Denmark, France, Italy, Luxembourg, Netherlands, Norway, Sweden, Switzerland and United Kingdom, plus, in subsequent agreements, Federal Republic of Germany, Japan and, in 1958, Finland. Neither club has a formal membership, and other countries—including notably the United States—have participated in their negotiations.

[3] The meeting of the Paris Club in June 1965, for example, was held at the French Ministry of Finance, and it was the Ministry that issued a *communiqué* on the results of the debt negotiations.

While not originally conceived as such, these clubs have tended to become financing mechanisms of a sort. Though concerned with financing the repayment of past debts, the problems that have influenced their creation and operation are not dissimilar to those that have to be faced in respect of the financing of future needs. Because of the number of creditor countries involved, bilateral negotiations with the debtor are awkward, not least because the equitable treatment that individual creditors are anxious to obtain in connexion with both debt repayment and future trade is more likely to emerge from joint discussion and arrangement. As far as the developing country is concerned, its convenience is also served by a multilateral mechanism and its desire to ease the burden of past debts is also motivated in large measure by future import needs and the problem of financing them.

AID CONSORTIA

It is thus a relatively short step from an international mechanism for rescheduling the past debts of a developing country to one that is designed to mobilize resources to finance its future import requirements. Such a mechanism came into being as the outgrowth of the balance of payments crisis that beset India in 1958. Under the influence of the second five-year development plan, imports rose by about 50 per cent between 1955 and 1957. As export earnings were rising at a modest 3-4 per cent a year, the trade deficit widened from little more than \$0.1 billion in 1955 to almost \$0.9 billion in 1957, and gold and foreign exchange reserves were halved, to a figure not much greater than the deficit. When the general trade recession of 1958 sharply reduced Indian exports (to below the 1955 level) and reserves dropped to \$0.7 billion, emergency action became imperative. The IBRD—from which India had received about \$200 million up to the end of 1957—convened a group of developed market economies in an "aid-India consortium" designed to mobilize sufficient external resources to prevent a disruptive cut-back in the second plan then in its middle year. The consortium, comprising Canada, the Federal Republic of Germany, Japan, the United Kingdom and the United States, plus the IBRD as sponsor and the IMF as observer, met in August 1958. Following a review of the situation, bilateral arrangements were made between India and the various participants to ensure that external financial resources for the essential maintenance needs of the economy in 1958/59 were made available without too drastic a revision of the second plan.

In the event, imports were reduced by about \$400 million from the high 1957 level and the trade deficit by about \$240 million. It was clear, however, that export earnings were unlikely to grow at anything like the pace of import requirements and that, given the low level of external resources, continuing support would be necessary to finance the remainder of the plan. Such support was organized bilaterally for the fourth year of the plan (1959/60) after a consortium meeting in March 1959, and for the final year (1960/61) after a meeting in September 1960.

At this third meeting, Italy was present as an observer and at the following meeting (in April 1961) there were several other observers—Austria, Denmark, France, Norway and Sweden—to join in a longer-range examination of the financing of the next five-year plan. By this time, India's external reserves had dropped to the equivalent of about three months' imports. At a resumed session at the end of May, members of the consortium—which now included France—committed themselves, subject to appropriate legislative or other authorization, to providing about $2.2 billion for the first two years of the third plan (1961/62 and 1962/63). This was intended to permit India to go ahead with the timely placement of import orders.

This 1961 meeting of the consortium was important not only because it was the first occasion of joint commitment of specific amounts but also for two other reasons. One was the stress that was laid on the need to take the precarious state of India's external balance into account in any decision regarding the terms on which resources were to be provided. The other was the position taken by the United States in making any increase in its 1962/63 commitment contingent on there being at least a matching contribution from the other members.[4]

At the fifth meeting of the consortium in January 1962 it was recognized that, though the flow of resources was keeping more or less in line with the 1961/62 commitments, more would have to be done: the trade deficit alone was now running at the record level of around $0.9 billion a year. One response was the recruitment of new members, and when the consortium met in July 1962, Austria, Belgium, Italy and the Netherlands had joined, bringing the total membership up to ten countries plus the IBRD and IDA, and raising the total 1962/63 commitments from the $0.9 billion originally pledged to $1.1 billion, compared with $1.3 billion for 1961/62.

A further $1.1 billion was pledged for 1963/64 at meetings of the consortium in June and August 1963. The need for easier terms was again stressed, as was also the need for flexible, uncommitted "non-project" resources available for financing current imports of raw materials, components and other producer goods for keeping the economy operating at a tolerable proportion of capacity. This was the plea at subsequent meetings of the consortium, too, when pledges were entered for similar amounts for the last two years of the plan (*see* table V-4). By 1965/66, up to half of new loan and grant commitments were being made free of any project tie, and up to two-thirds in the form of grants or low-interest long-term loans.

The procedures worked out by the Indian consortium set the pattern for those that followed—one for Pakistan, first convened by the IBRD in October 1960, as well as one for Turkey and another for Greece, both organized by the OECD in July 1962. The problems encountered by the Indian consortium were also repeated in one form or another—the need to start from a fairly specific and integrated plan in order to estimate the nature of imports and the magnitude of foreign exchange requirements, the impediment of legislative and administrative obligations in the making of pledges, the need to enlarge the list of contributing members, the need to provide for "working capital" as well as for the financing of new projects, and the need to keep the growth of the foreign exchange burden imposed by debt service down to a minimum. On the whole, the difficulties encountered in the Pakistan consortium were essentitially similar to those that had emerged in the case of India. Over the five years 1960/61-1964/65 it elicited bilateral commitments of almost $1.7 billion towards the financing of the country's second five-year plan (*see* table V-5). The Greek consortium seems to have been handicapped particularly by the absence of a formal plan showing the foreign exchange implications of intended investments, and the Turkish consortium by the heavy debt burden with which the country was already saddled when it entered the first year of the new plan in 1963.

The future of the consortium techniques of co-operation is by no means clear. It has been shown to be a very exacting exercise, both for the recipient and for the participating contributors. The potential advantages to be derived from it are likely to be greatest where financial requirements and the number of contributors—and hence the need for co-ordination—are greatest, but this is a situation in which the potential difficulties are also likely to be greatest. Governments that would be contributors are likely to be impressed by the risk that participation in a financing exercise of this nature might be thought to imply. This risk may be reduced by precise delimitation of the investment plan, by res-

[4] Over and above the commitment made at the fourth meeting of the consortium, the United States had undertaken to provide about $1.3 billion in the form of surplus commodities in support of India's third five-year plan. Canada had also promised grants of wheat.

Table V-4. Consortium for India: Pledges of financial assistance during the third five-year plan[a]

(Millions of dollars)

Pledging country or institution	1961/62	1962/63	1963/64	1964/65	1965/66	Five-year total
Austria	—	5	7	1	5	18
Belgium	—	10	10	—	4	24
Canada	28	33	30.5	41	41	173.5
France	15	45	20	20	20	120
Germany (Federal Republic)	225	139	99.5	95	86	644.5
Italy	—	53	45	36	36	170
Japan	50	55	65	60	60	290
Netherlands	—	11	11	11	11	44
United Kingdom	182	84	84	84	84	518
United States	545	435	435	435	435	2,285
IBRD and IDA	250	200	245	245	245	1,185
Total	1,295	1,070	1,052	1,028	1,027	5,472

Source: Press releases of the International Bank for Reconstruction and Development and the International Development Association.

[a] Fiscal years beginning 1 April of years indicated.

tricting commitments to an annual basis and by close and systematic surveillance of actual developments. But for the working of a consortium, the advantages of a specific and detailed plan depend in large measure on its full implementation, phase by phase, and as this in turn entails arrangements for financing over the whole period, it is difficult to avoid at least an implied commitment on the part of contributors going beyond the year for which pledges are actually made. Paradoxically, thus, an integrated development plan, while necessary to define and limit the obligations of the countries providing financial assistance, simultaneously tends —even if only implicitly—to enlarge their involvement beyond the annual commitment they might be able or willing to make.

In these circumstances, the success of a consortium is likely to depend on the confidence that can be inspired in contributing governments with regard to the adherence by the developing country to the plan which delimits their financial undertaking. For this purpose, great significance attaches to the role of an international organization—particularly one such as the IBRD, that can itself participate in the financing process—capable of providing both expert guidance to the developing country and more or less continuous surveillance of plan implementation.

ARRANGEMENTS FOR COMPENSATORY FINANCE

The risks associated with the financing of a development plan are not exclusively those of nonadherence. Often the most troublesome, indeed, are those that flow from the peculiar dependence of so many developing countries on a very limited number of export commodities. Variations in domestic crop

Table V-5. Consortium for Pakistan: Pledges of financial assistance during the second five-year plan[a]

(Millions of dollars)

Pledging country or institution	1960/61	1961/62	1962/63	1963/64	1964/65	Five-year total
Belgium	—	—	—	10	—	10
Canada	20	18	20	19	24	101
France	—	10	15	10	10	45
Germany (Federal Republic)	38	25	55	40	38	196
Italy	—	—	—	10	10	20
Japan	20	20	25	30	30	125
Netherlands	—	—	—	9	4	13
United Kingdom	22	20	28	22	22	114
United States	130	150	350	213	213	1,056
IBRD and IDA	—	77	132	80	80	369
Total	229	320	625	443	431	2,048

Source: As for table V-4.

[a] Fiscal years beginning 1 July of years indicated.

and fluctuations in world price tend to have a disproportionate impact on the export earnings of most of the developing countries. Given the stringency in foreign exchange that characterizes virtually all of these countries, a sudden downturn in export earnings can intensify very severely the difficulty of financing an import programme. This risk also tends to increase the reluctance of contributing countries to identify themselves completely with the financial underwriting that might be thought implicit in the operation of a consortium.

Various suggestions have been made for mitigating the effects of shortfalls in earnings on a country's capacity to pay for its imports.[5] In general they have involved some form of compensation, paid by trading partners or from an insurance fund dependent in varying degree on premiums levied on export receipts, to make good some proportion of the difference between actual earnings in a particular year and a norm calculated in some way from export performance in the recent past. None of the suggested schemes has been put into operation, and up to 1964 the principal tangible result of the recurrent discussion of the problem was the provision by the International Monetary Fund of an additional tranche of accommodation to member countries whose import capacity was impaired by a sudden decline in export receipts.[6]

In 1964 the matter was again debated, this time in the first United Nations Conference on Trade and Development. The result was a recommendation (A.IV.18) that recognized "that adverse movements in export proceeds of developing countries can be disruptive of development" and requested the International Bank for Reconstruction and Development to study the feasibility of a scheme to provide assistance that would supplement short-term balance of payments support and help avoid disruption of development programmes.[7] Following the guiding principles laid down in the recommendation, the staff of the IBRD drew up a scheme under which an international agency might administer a fund especially established for the purpose of furnishing "supplementary finance". This staff study was transmitted by the President of the Bank to the Secretary-General of the United Nations in December 1965 as being "worthy of the most careful consideration by all governments".[8]

In the present context perhaps the most significant aspect of the IBRD staff proposals is their departure from the more or less mechanical formula type of base which characterized earlier schemes. Such formulas, while intended in each case to provide a firm and objective criterion of need or claims for compensation, have in fact generally been regarded with misgiving: while objectivity in measuring a "shortfall" in export earnings was desirable, few of the countries that would be the scheme's principal source of funds welcomed the automaticity that was (or seemed to be) associated with it. The Bank staff proposals reintroduce the subjective attributes of control and discretion in the administration of a compensation fund. And this implies machinery for the prompt determination of need.

Machinery is also implied in the proposed method of arriving at the norm from which shortfalls might properly be measured. Instead of some historical average or trend readily calculable from published data, the Bank staff have suggested the use of the forward estimates of probable export earnings made for purposes of foreign exchange budgeting in the development plan itself. This would be no mechanical exercise in trend projection but a realistic appraisal of the short-run and medium-run prospects for the volume and price of each significant export commodity. This, in turn, would involve some degree of participation of the agency administering the compensation fund in the formulation of the development plan, at least to the extent of satisfying itself that the external transactions embodied in the plan were predicated on as realistic as possible an appraisal of future import capacity, including, in particular, that derived from export proceeds.

The administering agency would also have a special role to play in connexion with the payments made to a developing country whose plan has been placed in jeopardy by the vagaries of export earnings. The compensation fund would be drawn on only as a last resort, after every effort had been made to obtain assistance either by some bilateral arrangement or from one of the international institutions, particularly the IMF which, as indicated above, has already organized a facility for a compensatory type of accommodation.

The idea of an international body which has special advisory functions in respect of the external implications of the development plan formulated by a particular developing country and at the same

[5] The main proposals made between 1953 and 1963 have been discussed in various issues of the *World Economic Survey*, most notably those for 1958 (*see* chapter 3), 1962, Part I (pp. 55-58) and 1963, Part I (chapter 9).

[6] Described in International Monetary Fund, *Compensatory Financing of Export Fluctuations* (Washington, D.C. February 1963).

[7] United Nations, *Proceedings of the United Nations Conference on Trade and Development, Volume I, Final Act and Report* (Sales No.: 64.II.B.11), p. 52.

[8] International Bank for Reconstruction and Development, *Supplementary Financial Measures*, a staff report (Washington, D.C., December 1965).

time maintains close and effective liaison with various sources of finance is not entirely new. It is directly in line with recent experiments in fulfilling some of the essential functions of "aid consortia" while avoiding the specific difficulties which, as indicated above, formally organized consortia have encountered.

CONSULTATIVE GROUPS

The first experiment in international co-ordination of development aid was started in 1950 when a Consultative Committee of Commonwealth countries was set up to "survey the needs, to assess the resources available and required, to focus world attention on the development problems of [southern and south-eastern Asia], and to provide a framework within which an international co-operative effort could be promoted to assist the countries of the area to raise their living standards".[9] The result was the Colombo Plan which, starting with seven Commonwealth countries—Ceylon, India and Pakistan plus Australia, Canada, New Zealand and the United Kingdom—gradually expanded to embrace most of the countries of southern and south-eastern Asia and to include Japan and the United States among the more developed countries.

Participating countries were asked to draw up six-year programmes of economic development and, on the basis of these, regular joint consultations were held to exchange experience, discuss intentions and arrange for mutual assistance. The Consultative Committee has held annual meetings of senior officials and ministers, and between such meetings the work is carried on by an intergovernmental Council for Technical Co-operation. The Colombo Plan does not itself dispense funds; it merely provides a mechanism for the examination and comparison of country plans, for discussing needs and priorities and for facilitating arrangements for bilateral assistance. Formal commitments to provide such assistance have not been part of the ordinary procedure, though some countries—notably the United Kingdom—have in fact pledged particular amounts or types of aid.

The flow of resources through the Colombo Plan has been very small in comparison with the total amount moving to and from the participating countries. In the case of the United Kingdom, for example, between 1950 and 1963 the amount of assistance arranged through the Plan was of the order of $30 million, compared with a total of over $700 million actually provided to the developing countries in question and a further $450 million committed but not yet disbursed.

The distinctive feature of the Colombo Plan has been its emphasis on mutual aid. Though the resultant flow of resources has been overwhelmingly from high-income to low-income members, the Plan has specifically sought to avoid the donor-recipient form of confrontation, and a sizable amount of technical assistance—in the form of expert advice, training fellowships and so on—has in fact been provided by the less developed members.

While the Colombo Plan has thus made a unique contribution in emphasizing the mutuality of interests in organizing international assistance, the price of this has been a degree of looseness and diffuseness in its structure and operations which has greatly reduced its capacity to mobilize and direct development finance. More recent experiments have been designed with this latter function mainly in mind: they have resulted in mechanisms by which various sources of finance can be brought to focus on the development needs of a particular country.

The first of these new consultative groups were set up by the IBRD in 1962 following requests by Colombia and Nigeria to have aid consortia established on their behalf. The principal prerequisite for an operational consortium was absent: in neither country was there a comprehensive and articulated development plan revealing in the necessary detail the nature and order of magnitude of the need for external resources. Potential providers of financial assistance were reluctant to come together in anything resembling a pledging conference. The alternative devised by the Bank was a less formal type of mechanism which would facilitate consultation and advice on the one hand and the arrangement of *ad hoc* bilateral loans and grants and other forms of aid on the other.

The countries agreeing to constitute the Nigerian Group were Belgium, Canada, the Federal Republic of Germany, Italy, Japan, the Netherlands, Switzerland, the United Kingdom and the United States plus the IBRD and the IDA. Together with Denmark, France and the IDB, the same nine countries constituted a similar Group for Colombia. Subsequently, Groups of essentially the same nature were set up for the Sudan and Tunisia (under IBRD auspices), and for Ecuador (under the auspices of the IDB). More recently, preliminary steps have been taken to form Groups for Malaysia and Thailand, and others are contemplated, in line with recent policy decisions of the IBRD.

[9] *The Colombo Plan, Eleventh Annual Report of the Consultative Committee* (London, Her Majesty's Stationery Office, January 1963, Cmnd. 1928); *see* also the original report by the Commonwealth Consultative Committee, *The Colombo Plan for Co-operative Economic Development in South and South-east Asia* (London, Her Majesty's Stationery Office, November 1950, Cmd. 8080).

It is too early to assess the achievements of any of these Groups, particularly as political instability in some of the developing countries concerned has since exercised an inhibiting effect on their economic development. The purpose intended, however, is clear enough in general terms: it is to maintain liaison and build up confidence between the developing country and its main sources of external finance. To do this it is necessary in each case (*a*) to support the developing country with whatever advisory and technical assistance services seem necessary in connexion with economic plan and project formulation, (*b*) to help as far as possible with the actual financing operations and (*c*) to provide sufficient surveillance over the use of funds to convince the participants in the Group that the resources that they are furnishing are being deployed to maximum effect and that they will be alerted if the course of development shows any sign of going seriously awry.

If a mechanism of this nature were able to function effectively, it would offer a number of advantages. For the developing country, the problem of obtaining external finance is likely to be materially eased: sources would be more accessible, opportunities for making choices of origin and form more rational would be improved and procedures greatly simplified. For the lending countries, expert objective opinions would be available on questions of investment priority and project viability as well as on actual resource utilization. In this way even *ad hoc* project financing would be undertaken in a more coherent framework. Large-scale projects could be viewed more readily as joint responsibilities for which several countries might share in the financing—as, indeed, has already occurred in the case of the Niger Dam for which arrangements were made in the Consultative Group for Nigeria. And although there would be no systematic gap-filling pledging, such as distinguishes the consortium method, the Group would be able to see and take due account of the over-all development programme—or, at the very least, an articulated set of projects—and the various provisions that are being made for its financing.

Apart from the effect that such a group might have by way of improving the terms on which the developing country was able to borrow, it might also be in a strategic position to help with the problem of refinancing should the need arise. Such a function requires negotiation among creditors no less than between debtor and creditor and, as indicated earlier in the chapter, in the past, *ad hoc* groups—such as the Paris Club and the Hague Club—have been used for the purpose. By virtue of its continuous interest and its positive impact on the direction and terms of lending, a consultative group might, however, serve to prevent the piling up of debt and debt-servicing obligations to crisis proportions. Indeed, one of its main objectives would be to steer clear of any course of action that might lead to its transformation into what might be regarded as a creditor club.

In these circumstances, the success of a consultative group is likely to depend very largely on the measure of mutual confidence that is generated among the participants. This in turn will depend on the sponsorship of the group and the professional competence with which its routine work—and particularly its surveys and appraisals—is carried out. Up to now the IBRD has played the major role, and recent pronouncements have indicated its intention to pursue this form of activity more vigorously in the future. Logic and convenience suggest that in due course the newer regional banks may also have an important contribution to make in this effort to co-ordinate aid to the developing countries in Latin America, Africa and Asia, respectively. As indicated above, the IDB has already assumed responsibility for one group. As lending agencies themselves, the regional banks will in any case need to build up the requisite expertise, and in due course they should be in a position to identify themselves both with the more developed countries that furnish resources and with the recipient developing country.

Apart from the key role of executing agency which will tend to be an essentially similar one, the size and operation of the group may differ appreciably from case to case, depending to a large extent on the magnitude and complexity of the developing country's needs. There would seem to be no reason why the composition of a particular group should not be varied in accordance with specific needs. The IMF has been represented as observer at all the meetings of the groups so far constituted. Five other Latin American countries attended the May 1965 meeting of the IDB-sponsored Ecuador Group at which the financing of the first three years of that country's ten-year development plan was discussed. The IBRD also attended that meeting, just as the IDB has participated in the IBRD-sponsored Group for Colombia. The European Investment Bank (EIB) and the UNSF were represented at the December 1965 meeting that reviewed Tunisia's four-year plan. And UNDP observers were present at the meeting of the Nigerian Group in February 1966.

Whether experimentation with various forms of co-ordinating groups will serve to stimulate a greater flow of resources to the developing countries has yet to be demonstrated. The main hope at this stage is that the use of such groups will increase the development potential of a given flow. Even if the flow remains essentially project-directed, the fact that the project can be viewed within an integrated investment nexus, supported by the appropriate technical assistance and training facilities, and if necessary tackled jointly by several capital exporting countries, should lead to marked improvement in resource utilization.

Other international efforts to increase the flow of resources

Over and above the multilateral institutions and funds that have been established since the war for the specific purpose of transferring or directing various types of resources to the developing countries, a number of other international means of achieving the same purpose have been discussed and, in one or two cases, put into practice.

The area of most extensive debate has been that of trade—the means by which, in any event, the developing countries ordinarily obtain the bulk of their external purchasing power. A sustained effort has been made, first through the General Agreement on Tariffs and Trade (GATT) and more recently through the United Nations Conference on Trade and Development (UNCTAD), to increase the gains derived by the developing countries from their exports. These multilateral efforts, like the bilateral measures discussed in chapter IV above, have yielded relatively little in the way of easier access or improved terms, however: the goods concerned, being predominantly primary commodities, have faced not only unfavourable demand conditions but also one of the most recalcitrant elements in the commercial policy of almost all the developed market economies, whose primary producing sectors have pressed strong social and economic claims to official protection or support. Among the few gains so far recorded is a widespread agreement to reduce the obstacles to trade in various "tropical" products and to waive the general reciprocity rule in respect of trade concessions made to developing countries by the developed market economies.

For a handful of primary commodities—wheat, sugar, tin and coffee—more formal and comprehensive international arrangements have been made. For many reasons, however, success has been meagre, even in terms of the short-term price stabilization function which has been the principal objective of almost all these agreements.[10] Their effectiveness as a means of placing additional external resources at the disposal of the developing countries has generally been minimal.

The only comparable effort in respect of manufactured goods has been the long-term Cotton Textiles Arrangement of 1962 which sought to stabilize the growth of exports of cloth from the developing countries to the developed market economies. The effect of this on the longer-term textiles earnings of the developing countries is impossible to determine: it replaced a rapid—and potentially disruptive and hence probably short-lived—expansion of exports from a small group of developing countries by a slow but presumably more assured growth subject to bilateral quotas and periodic review.

Apart from cotton textiles, exports of which—like those of many primary commodities—face the difficulties that flow from the particular vulnerability of producers in most of the developed market economies, there are relatively few manufactured products from which the developing countries might hope to obtain a rapid or sizable increase in export earnings. To meet this situation, recent international debate has shifted to an exploration of the feasibility of some system of preferences which would open part of the market in the higher-income countries to the exports of manufactures from the developing countries on terms that gave them some competitive advantage to offset the handicaps arising from their industrial immaturity. Various ideas have been put forward but as this is an area in which some of the major importing countries are reluctant to introduce a discriminatory principle into their trading practices, the matter has not gone beyond the exploratory stage of discussion.[11]

As far as its effect on the capacity of a developing country to finance its economic development is concerned, an increase in exports differs in many ways from the receipt of a loan or a grant. What has been stressed in most debates on trade policies in recent years is not the developmental impact of the domestic ramifications of an increase in export activity but the importance to most developing countries of obtaining more freely usable foreign exchange. This reflects the high propensity to import that characterizes almost all developing countries, especially when their development effort is stepped up,

[10] For a discussion of the problems of access to markets for primary products and international stabilization measures, see *World Economic Survey, 1963, Part I* (Sales No.: 64.II.C.1), section II.

[11] See *World Economic Survey, 1963, Part I*, p. 203 *et seq*, for an exposition of some of the problems involved, and UNCTAD, "Preferences: Review of Discussions, Report by the Secretary-General of the Conference" (TD/B/AC.1/1) for a summary of recent deliberations on the subject. *See* also UNCTAD, "Report of the Special Committee on Preferences" (TD/B/C.2/1).

and the resultant balance of payments strains that have been equally characteristic of developing countries in recent years. The latter have given rise to discussions about the possibility of a more direct approach to the liquidity problem of the developing countries.

While the debate on the role of trade expansion in the process of economic development has continued throughout the post-war period, the discussion of the possibility of putting additional resources at the disposal of the developing countries directly through the mechanism regulating international liquidity is relatively recent. It has become increasingly germane and urgent as, under the pressure generated by the balance of payments situation of the reserve currency countries, the whole international monetary system has been subjected to an exhaustive examination.

In the present context the main point at issue in these recent discussions has been the best means for sustaining—and, as necessary, expanding—total international liquidity in the face of efforts on the part of the United States to correct its payments imbalance, which throughout the post-war period has been instrumental in providing a large proportion of the increment in the world's monetary reserves. In so far as, in a reformed system, international credit would be created deliberately and not left to expand fortuitously in accordance with the deficits registered by major trading countries, the question of greatest concern to the developing countries is where such credit might most appropriately be injected into the system.

One recent proposal—made by a group of experts convened by UNCTAD—envisages a direct link between the creation of international liquidity and the provision of development finance.[12] This link, it is suggested, could be achieved by passing on to the IBRD as loans part of the national currency deposits made by member countries for the purpose of backing a new international reserve unit. In this way, the Bank (and presumably the IDA) would be put in a position to increase its lending to the developing countries, and this in turn would increase their imports (particularly of capital goods) from the more advanced countries which would be the main contributors to the total monetary reserve. The process of increasing liquidity—in which the more advanced and the less developed countries would all share—would thus be followed in fairly short order by a transfer of real resources to the developing countries.

[12] *See* United Nations, *International Monetary Issues and the Developing Countries*, Report of the Group of Experts (Sales No.: 66.II.D.2).

It has been suggested as an alternative link between the increase in international liquidity and the provision of resources to the developing countries, that one of the criteria for determining the distribution of any increment in a new monetary asset chosen to underpin international reserves might be each country's aid effort.[13] This would be a less direct link, but it would serve as a stimulus to the more advanced countries to expand the outflow of resources to the developing country in the knowledge that their own external liquidity was not going to suffer unduly as a result.

Another proposal for putting additional resources at the disposal of the developing countries is at present before the international community. This is the idea of a multilateral fund which could be used for making good the difference between the rate of interest at which an institution such as the IBRD might borrow from the capital market and the rate at which it found it expedient to lend to developing countries. As indicated in chapter IV above, use of an interest subsidy fund of this nature would enlarge the access of developing countries to the private capital market in various developed market economies. What sort of international institution could best act as an intermediary for this purpose and how its borrowing might least disruptively be distributed among the various markets and over time are subjects at present being debated.[14]

A multilateral approach has also been urged to meet some of the problems of direct private investment. Efforts have tended to concentrate, though with quite varying degree of success, in three specific areas—the adoption of some form of investment code, the organization of a multilateral system of investment guarantees and the establishment of machinery for settling disputes.

Least advanced—understandably, in view of the complexities outlined in chapter IV—is the question of an internationally acceptable code governing private foreign investment. The nearest approach to international action on the subject has been in con-

[13] *See* the statement of the Governor of the IMF for France at the twentieth Annual Meeting in International Monetary Fund, *Summary Proceedings, 1965* (Washington, D.C.), p. 128. The question of the creation of reserve assets had been examined by a study group of the Group of Ten in 1965, and at a later session of the Annual Meeting it was agreed that the Group of Ten should negotiate the matter and bring the result before the Fund at its 1966 Annual Meeting.

[14] In its present form the proposal was put forward by Mr. D. Horowitz, Head of the Delegation of Israel to the first UNCTAD in April 1964. It was the subject of a staff report of the International Bank for Reconstruction and Development, *The Horowitz Proposal* (Washington, D.C., February 1965). It was further examined in April 1966 by an expert group appointed by the UNCTAD Committee on Invisibles and Financing related to Trade. *See* chapter II above.

nexion with so-called non-business risks: in 1962 the OECD published a "Draft Convention on the Protection of Foreign Property" embodying principles designed to ensure, for foreign investment, equitable treatment, physical security, safeguards against unreasonable or discriminatory measures and just compensation in the case of nationalization. Though several developed market economies have concluded agreements of this nature bilaterally with various developing countries, the more general convention has not gone beyond the discussion stage.

Under more active consideration is a scheme for multilateral investment guarantees. In its present form this had its genesis in a staff report of the IBRD prepared for the OECD in 1962, on the basis of which the latter drew up proposals for the international corporation that could insure new private foreign investment against various non-commercial risks. Approval by both the country of origin of the capital and the host country would be a prerequisite for any guarantee, but losses would normally be shared among the capital exporting members in accordance with a formula reflecting the extent of use of the facilities both as a whole and in the country in which the loss had occurred. In mid-1965, the OECD transmitted a report on its proposals to the IBRD for study, and the result of this is to be considered by the Bank's executive directors later in 1966.[15]

As indicated in chapter IV, several of the developed market economies operate their own schemes for guaranteeing the direct investment of their nationals abroad. Almost inevitably, in order to accommodate a wider variety of conditions and risks, a multilateral scheme is likely to be looser and less detailed then a national one, but at the same time, multilateral guarantees would not necessarily be incompatible with national schemes run on a bilateral basis: the latter could continue to operate in cases where more detailed or more comprehensive insurance is practicable.

International discussions in the third of the areas indicated above—namely, the settlement of disputes involving foreign investors—have already borne fruit in the form of a Convention contemplating the establishment of an autonomous Centre under the auspices of the IBRD.[16] This machinery will come into effect when the Convention has been signed and ratified by twenty states. (By March 1966 there were thirty-three signatures and four ratifications.)

The Centre will make available facilities to which contracting host states and foreign investors who are nationals of other contracting states will have access on a voluntary basis for the settlement of investment disputes between them, in accordance with rules laid down by the Convention. The method of settlement might be conciliation or arbitration, or conciliation followed, if necessary, by arbitration. The initiative for such proceedings could come either from a state or from an investor. The Centre will not itself act as conciliator or arbitrator but will maintain panels of specially qualified persons from which conciliators and arbitrators may be chosen. Recourse to the facilities of the Centre will be entirely voluntary, but once a state and a foreign investor have agreed to use the Centre they will be required to carry out their agreement, to give due consideration to the recommendations of a conciliator and to comply with an arbitral award, as indeed will other contracting states, too.

While the Centre will deal only with legal disputes, it will fill what is at present an awkward gap in international machinery. Its successful operation should thus contribute to improving the climate for direct investment and hence act as a stimulus to the flow of private capital to the developing countries.

In some ways the cornerstone to this building up of mechanisms, institutions and incentives to stimulate and facilitate the flow of resources to the developing countries has been the setting of targets. Denominated at first (in 1960) in the crudest of terms, these targets have undergone some refinement and though they remain vague at many points there is a discernible tendency towards making them more precise. There is also a discernible desire to increase the operational significance of the target for international resource flow, to make it consistent with other targets that have been set and to make the Development Decade a coherent framework within which to marshal international effort.

The first target for resource transfer set one per cent of the combined "national income" of the more "advanced" countries as the level to be attained as soon as possible (*see* General Assembly resolution 1522 (XV) adopted in December 1960). The absence of any definitions of the relevant variables was partially remedied in 1964 at the first UNCTAD session where the particular flows to be taken into account were detailed and the target made applicable to individual "economically advanced" countries rather than to an undefined group (*see* UNCTAD recommendation A.IV.2). The recipient

[15] *See* United Nations Conference on Trade and Development, "Report on the Status of the International Bank Studies on Multilateral Investment Guarantees" (TD/B/55, 3 February 1966).

[16] For earlier efforts by the United Nations and the background to the more recent discussions, *see* United Nations, "The Promotion of the International Flow of Private Capital" (E/3905/Add.1, 26 May 1964), pp. 18-22

group was left undefined, however, and so was the denominator of the target ratio.

In 1965 it was proposed—at a High-level Meeting of the Development Assistance Committee (DAC) of OECD—that subsidiary targets be set for the proportions of loans made at extra low rates and for extra long periods. It was recommended that member governments raise the proportion of loans at 3 per cent or less and for twenty-five years or more to at least 80 per cent of the total made to developing countries, and that a grace period averaging seven years be granted before amortization payments were collected. This target was made rather more exacting than earlier ones by the setting of a specific time limit: members were urged to attain the indicated minima within three years, at which time there is to be a revision of the objectives in the light of the progress made and "of other relevant factors".[17]

Apart from the targets actually set, a number of others have been discussed. It has been suggested, for example, that the global target for resource transfer, already made applicable to individual capital exporting countries, be refined further to allow sub-targets to be set for official flows—private flows being much less amenable to influence or control—and also for the flows directed to the international institutions, either as a proportion of the total or as a separate fraction of national income or gross production. The desirability of prescribing limits to the extent of loan "tying" and to the degree of country concentration of grants has also been discussed. Though, because of all the complexities examined in previous chapters, no specific objectives have emerged in these additional areas, it is clear that the setting of targets has come to be regarded as a workable means not only of expressing internationally accepted intentions but also of stimulating national action in line with those intentions.

Notwithstanding the rider to the 1964 UNCTAD recommendation A.IV.2 to the effect that "this is not intended to represent either a ceiling or a suitable method for comparing the appropriate quantitative or qualitative development assistance efforts as between different economically advanced countries",[18] it is probable that it is precisely through such comparisons that targets of this sort actually tend to exercise their greatest effect. Nations, no less than taxpayers, are likely to contribute to common goals far more willingly if there is tangible evidence that the basis for exacting the contribution is an equitable one.

To some extent, thus, the setting of targets is part of a "burden sharing" exercise: the principle of transferring resources from high-income to low-income countries having been accepted, the targets serve not only as a general stimulus but also as a means of equalizing the effort involved. This emerged most explicitly from the DAC discussion that led to the setting of targets for the "soft" sub-commercial component of loans. Urging the need for "harmonizing" the terms of lending, the DAC Chairman argued that "continuing disparities among lenders represent not only potential problems for recipient countries with accumulating debt service burdens, but also raise serious problems of inequity among the creditor countries. The presence of some credits at hard terms may imperil the situation of all lenders by multiplying the risks of default through building up an unmanageable debt burden. Further, the necessity for hard loan debt servicing may raise the requirements of the borrower from other suppliers of assistance. In fact, the soft assistance may in effect make it possible for the recipient to service harder loans".[19]

It would be fanciful to regard the complex of targets now emerging as an embryonic tax system on a global scale. Yet it is clear that though the task of transferring resources to the developing countries is a self-imposed one and its fulfilment by the more advanced countries purely voluntary, its quantification in the form of national targets reflects the need that has been felt to apply to it some of the canons of tax policy as these have evolved within individual economies for purposes of equitable redistribution of income. Though there is no machinery for enforcement, experience has shown that the process of regular confrontation—both between net contributor and net recipient and among the various net contributors themselves—is not without effect upon performance.

The more seriously targets are to be taken the more care will be required to make them realistic, measurable and equitable. To be realistic they need to be ahead of actual achievement by a margin that is sufficiently wide to act as a stimulus, even to countries with the best performance, but not so wide as to be manifestly unattainable within the sort of time period that is politically feasible for confrontation purposes. To be measurable they need to be defined with sufficient precision to permit the presentation of performance in terms of convenient, comprehensible and convincing data. To be equitable they need

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[17] *See* Organisation for Economic Co-operation and Development, *Development Assistance Efforts and Policies, 1965 Review, Report of the Chairman of the Development Assistance Committee* (Paris, 1965), annex B.

[18] United Nations, *Proceedings of the United Nations Conference on Trade and Development, Volume I, Final Act and Report*, p. 44.

[19] Organisation for Economic Co-operation and Development, op. cit., p. 89.

to take into account not only what might be regarded as the basic taxable capacity of the capital exporting countries but also such other relevant circumstances as to the form in which the resources are being made available and the current economic situation in the countries concerned.

The problem that lies ahead is to increase the operational significance of the target-setting technique. In one sense this is an extension, on to the international plane, of the planning problems that have to be solved at the national level. In the context of the Development Decade, a sizable number of targets are being set.[20] Their effect, both as a stimulus to effort and, no less important, as a guide to the way in which that effort—and the resources that are comprehended in it—should be distributed, depends upon their degree of realism and their mutual consistency. More specifically, the usefulness of a resource transfer target can be judged only in the light of related targets for growth, savings and foreign exchange earnings of the recipient countries.

In 1965 the Economic and Social Council provided itself with the means for improving the effectiveness of the target-setting exercises conducted in various bodies in the United Nations family: it provided—in resolution 1079 (XXXIX)—for the establishment of an expert Committee on Development Planning. One of the functions of this Committee—as visualized by the General Assembly in its resolution 2084 (XX)—would be "to explore . . . the possibility of establishing a more comprehensive and coherent set of goals and objectives, so that a balance-sheet of the United Nations Development Decade and subsequent periods may be prepared and a method devised for the systematic evaluation of progress and prospects".

This connexion between resource transfer targets and development planning lies some way ahead. For the present, their main significance lies elsewhere. Even on the tentative experimental basis that has characterized them so far, the targets that have been set in respect of the volume, composition and terms of resource transfer constitute tangible evidence of a sense of shared responsibility for the global distribution of incomes and for correcting disparities in rates of economic growth. The continued evolution of a system of such targets now in prospect would represent a major step forward in the international financing of economic development.

[20] *See* United Nations, "The United Nations Development Decade, Interim Report by the Secretary-General" (E/4196).