

**United Nations**  
**ECONOMIC**  
**AND**  
**SOCIAL COUNCIL**

**Nations Unies**  
**CONSEIL**  
**ECONOMIQUE**  
**ET SOCIAL**

UNRESTRICTED

E/CN.1/71  
10 May 1949

ORIGINAL: ENGLISH

ECONOMIC AND EMPLOYMENT COMMISSION

Fourth session

Items 5 and 6 of the agenda (E/CN.1/64/Rev.1)

MEMORANDUM OF THE INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT TO THE  
ECONOMIC AND EMPLOYMENT COMMISSION

1. The staff of the Bank has reviewed the reports of the two Sub-Commissions of the Economic and Employment Commission, the one on Economic Development (E/CN.1/65) and the other on Employment and Economic Stability (E/CN.1/66).
2. So far as the Bank is concerned, it is impossible to reconcile fully the objectives at which these two reports aim. On the one hand, the development of under-developed countries requires a steady flow of investment in an orderly series of projects; on the other, anti-cyclical action demands sudden acceleration or curtailment of the investment programme to meet changes in business conditions, which are often abrupt and foreseeable only a short time ahead. To make anti-cyclical action a primary object of the Bank's investment policy would tend to upset the balance which any long-term development plan requires among the various branches of the economy such as transport, power and the training of labour.
3. In addition to this general observation on the two reports taken in conjunction, a number of comments on each individual report are set forth in the following paragraphs.

Economic Development

4. In its memorandum to this Commission of 6 April 1948 (E/CN.1/50) the Bank has already stated its views on the desirable pattern for development. In view of the emphasis which the Sub-Commission places on industrialization in general and heavy industry in particular, it is desirable to repeat some of its observations.
5. The application of capital to the improvement of the real income per head in a country must be viewed in a broad sense. The Sub-Commission does point out the importance of agriculture in development, but the stress is  
/on industrialization.

on industrialization. However, in the Bank's experience, the shortest road to a higher real income is often investment in agriculture. And, particularly when agricultural techniques are primitive, the best results may be obtained not by large-scale mechanization but by the distribution of many simple tools. But this very improvement of agricultural methods may well cause underemployment or, worse still, accentuate it where it exists already as it so often does in populous areas. The necessary concomitant is then investment in light industries - light, that is, in the sense that they have a high ratio of labour to capital. For the whole process of development inherently entails a large proportion (as much as 50 to 60 per cent) of the total investment in "public overhead capital" which is capital intensive. When so much capital is necessarily earmarked for such purposes, it becomes all the more desirable to ensure the best use of the remainder. It is therefore natural to find that small scattered units of light industry, which can often be developed from local handicrafts, are frequently more rewarding than concentrated heavy industry, especially in countries where there are natural obstacles to transportation.

6. Excessive emphasis on industry for industry's sake, above all heavy industry, may leave an undeveloped country with the symbol of development rather than the substance. There are, of course, a number of instances where heavy industry may be justified. For example, production of iron and steel in Southern Rhodesia is clearly economic both because of the existence of the requisite natural resources and because of the high overland transport cost of imported iron and steel. But, in general, capital should be applied where it brings the greatest return. For this reason the prime need in development might be better termed "capitalization", which embraces all forms of physical investment and does not have the somewhat misleading bias that "industrialization" has.

7. On the domestic aspects of financing development and the proper employment of domestic resources, the Sub-Commission has made a number of apt observations which the Bank believes that the Commission should strongly endorse. It is perhaps pertinent to add that, whereas "the main cause of low savings is the low level of real income", one reason for this low level is often seasonal or disguised unemployment in rural areas. In such conditions, certain types of capital formation are possible that involve little or no inroads on existing real income. Simple construction work, such as village health centres, storage buildings, feeder roads and water catchments may be carried out voluntarily by the local inhabitants

/themselves if

themselves if the State supplies some of the materials. Except for the cost of the latter, this form of development requires no financing. But where a spirit of communal co-operation is keen and widespread, it can be of substantial importance.

8. In its discussion of foreign direct investment, the report rightly points out the conflicting conditions demanded by governments of under-developed countries and by would-be investors. It is easy to appreciate the fears of both sides and their consequent desire for security, but it is not so certain that the remedy is to re-assert only the justice of the governments' claims. Although it is entirely justified that under-developed countries take protective measures against abuse of private investment, it is possible that more may be lost than gained by the imposition of regulation according to a strict legal formula. Conditions are so varied that the efficient management of businesses can hardly be compatible with a single arbitrary set of rules. The aspirations of both governments and investors can best be fulfilled by an atmosphere of mutual trust and a common ground of interest. It should be possible for the Bank to assist in the creation of such an atmosphere in general and possibly in some instances participate with foreign capital so as to increase the confidence of both parties. Otherwise, a thirst for independence may inhibit the interdependence which it is in the interest of all to promote, so long as it does not imply subservience.

9. The advantages of foreign direct investment are considerable. In general both real income and foreign exchange receipts of the country are increased without the burden of fixed interest and amortization payments. Nevertheless, some care is needed to preserve a proper balance within the economy and to avoid certain dangers. For example, enterprises which start modestly but have the promise of stability and growth by regular reinvestment may in the long run prove more beneficial than those which are interested solely in quick returns and the withdrawal of their investment after a few years, even if their capital is much greater. In the latter case, the misuse of certain resources such as mines and forests must be guarded against. Furthermore, the effect on the balance of payments cannot be ignored. In certain cases, the result may be a saving of imports from a foreign country, with which the under-developed country already has a favourable balance, at the expense of added payments in "hard" currency.

10. An under-developed country has limited resources of skilled labour, power, transportation, etc. It is entitled to exercise safeguards in order to make as good use of them as possible. It should be able to achieve much by fiscal measures that are not unduly discriminatory. But if unwarranted or unduly rigid restrictions on foreign capital are imposed, such capital will not be forthcoming and the pace of development will accordingly be slowed.

11. The Sub-Commission considers it unrealistic to assume "that the Bank could, in the foreseeable future, be able to make a significant contribution to the massive investments required for economic development involved over a long period." The magnitude of the task cannot be denied, but magnitude alone cannot determine the pace at which it is undertaken. The report itself admits the dearth of soundly conceived projects and this agrees with the Bank's experience. Rash expenditure now would prejudice the flow of investment in the future; for in the last resort development relies on the savings of the world, which can hardly be expected to be forthcoming if they are misused. Eventually more sound projects may be presented to the Bank than it can finance, but that time is not yet in sight.

12. The dearth of sound projects is not particularly surprising. The very fact of under-development connotes an insufficiency of the talents, not always involving the highest skills, necessary to translate development concepts into practical propositions ready for execution. Moreover, the last 20 years have witnessed a cataclysmic depression and a long destructive war -- hardly a fertile period for the preparation of long-term development plans. But not only have the plans not yet been made; even the material is lacking. Data of all kinds, including economic, are fragmentary and often unreliable. The need for hydro-electric power and irrigation, for example, will in many areas take some years to satisfy simply for the lack of geological and hydrological information. In addition, the necessary political and social foundations for development can only gradually be built. Low productivity and living standards are as much the product of poor government, unsound finance, bad health and lack of education as of inadequate resources or the lack of productive facilities. The Bank hopes that through the technical assistance rendered by it and by other international and national agencies these hurdles can be lowered.

13. The Bank will not be deflected from its determination to make loans only for sound and productive projects. For the efficient canalization of savings is as essential on the international plane as it is on the domestic. Any organization which lowered its standards in this respect would be guilty of waste for the sake of an ostensibly humanitarian gesture. The Bank has no intention of so abusing its responsibilities. This does not mean, of course, that the Bank finances only projects which pass private investment criteria. To the contrary, the Bank's charter expressly precludes it from making loans when financing is available from other sources on reasonable terms; its purpose is to finance projects of a type unattractive to private capital or involving risks which private investors are unable or unwilling to assume. None of the loans made by the Bank to date could have been financed privately.

/14. The Bank's

14. The Bank's interest in under-developed countries is not a temporary one, limited to the negotiation of a loan. It continues to have the normal creditor's interest in its loans, most of which are long-term, and does not lose this interest when it resells the securities it holds, since they still carry the Bank's guarantee. But its role is not merely that of a creditor. Its customers are also its stockholders. The Bank therefore has a dual function, to promote sound financial conditions in its under-developed member countries and at the same time to safeguard their welfare. To the extent that it is successful by advice and by financial assistance in promoting sound economic progress in a country, the climate for other types of investment should improve and the power of the government itself to undertake the types of investment unattractive to private capital should be enhanced. Thus the indirect consequences of the Bank's close connexion with a country's development may well be greater than the direct.

15. The proposal for the so-called UNEDA, which is attached as Annex A to the report, is based on an alleged need for a new international agency to perform four particular functions. The first such function is "financing projects of economically under-developed countries which are not financially productive in a banking sense". As already pointed out, the Bank itself was established to finance development projects for which private capital is not available, provided only that the projects are productive and that reasonable prospects of repayment exist. The obstacles which have thus far prevented a greater volume of investment by the Bank have been imposed by external circumstances and not by charter limitations; the mere creation of a new lending agency will do nothing to remove them. The only new feature of UNEDA in this connexion is that its loans might be at nominal interest rates and might be repayable over a very long period of time. However, since loans made by the Bank are on terms which are not designed to make any substantial profit, it is clear that any greater liberality in the terms of UNEDA loans would amount simply to disguised inter-governmental grants. The second purported function of UNEDA, aid to "under-developed countries in the preparation and/or execution of their programmes of economic development", is one which the Bank has been performing for some time. The third function, which concerns co-ordination of technical assistance and linking it with financial assistance, is stated in terms which are too broad to give a useful idea of its intended scope. But it should be noted that the Bank has been in close consultation with the United Nations, the Fund, FAO and other international organizations for a long time and plans for co-ordination of the technical assistance programmes of all the agencies are well advanced. The fourth function mentioned is the promotion of or aid in "the execution  
/of projects

of projects of economic development extending over more than one national frontier and not likely to be taken up by any one of the countries concerned, on its own initiative". This, again, is an aspect of development which falls squarely within the Bank's sphere of responsibility; the Bank has been considering several such schemes. The fact that final agreement on a scheme of this type has not yet been reached is an index of the practical difficulties involved rather than of inactivity.

#### Employment and Economic Stability

16. The Bank's primary interest must remain the smooth progress of development plans in its member countries. The main burden of responsibility for taking anti-cyclical action inevitably rests first on the governments of the principal industrial countries and secondly on the Fund and any international agency or agencies which may be formed to carry buffer stocks.

17. However, it should not be forgotten that merely by continuing investment at a steady rate throughout the business cycle, the Bank will be making a contribution to anti-cyclical action, since international investment normally undergoes a sharp fall during a depression. Furthermore, there are reasons why, in the nature of things, there may be a tendency for the Bank to increase its lending during a depression, for the terms upon which capital equipment can then be secured may make economic projects which might be unsound during a period of high prices. But the first consideration in timing bank financing must remain the investment needs of its member countries

-----