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Problems and policies of financing

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NOTE

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V. Special Problems in World Trade and Development

Volume IV

Problems and Policies of Financing

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EXPLANATORY NOTE

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

A dash (—) in a table indicates that the amount is nil or negligible.

Unless otherwise stated, parentheses round a figure, e.g. (25.3), indicate that a figure is an estimate.

A hyphen (-) between dates representing years, e.g., 1950-1960, is used to signify the full period involved, including the beginning and end years.

An oblique stroke (/) between years indicates a crop year or fiscal year, e.g., 1961/1962.

Reference to tons indicates metric tons.

Reference to " dollars " ($) indicates United States dollars, unless otherwise stated.

The term " billion " signifies 1,000 million.

Reference to annual rates of growth or change indicates compound rates.

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

ABBREVIATIONS

BIS	Bank for International Settlements
CCC	Commodity Credit Corporation
CENTO	Central Treaty Organization
c.i.f.	cost, insurance, freight
CMEA	Council for Mutual Economic Assistance
DAC	Development Assistance Committee (of the Organisation for Economic Co-operation and Development)
ECAFE	Economic Commission for Asia and the Far East
ECLA	Economic Commission for Latin America
EDF	European Development Fund
EEC	European Economic Community
EFTA	European Free Trade Association
EIB	European Investment Bank
EPTA	Expanded Programme of Technical Assistance
Eximbank	Export-Import Bank of Washington
FAO	Food and Agriculture Organization of the United Nations
f.o.b.	free on board
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNP	Gross national product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
KW	Kreditanstalt für Wiederaufbau (Federal Republic of Germany)
OAS	Organization of American States
OECD	Organisation for Economic Co-operation and Development
SITC	Standard International Trade Classification
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFC	United Nations Fund for the Congo
UNHCR	Office of the United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
UNRWA	United Nations Relief and Works Agency for Palestine Refugees in the Near East
UNTA	United Nations Technical Assistance
USAID	United States Agency for International Development
WFP	World Food Programme

GROWTH AND AID

DOCUMENT TD/7

Growth, development financing and aid: issues and proposals study by the UNCTAD secretariat

[Original text: English]
[11 October 1967]

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Chapter I

Internal resources and external assistance

(a) *The need for external assistance*

1. In response to recommendation A.IV.2 of the United Nations Conference on Trade and Development at its first session[1] the secretariat has undertaken a country-by-country examination of the trends and prospects for both the domestic and external sectors of the developing countries.[2]

2. The studies show that for a large number of developing countries not only is the availability of foreign exchange already a major constraint on growth but it is likely to become increasingly so during the years ahead.

3. While the export demand for petroleum products and certain types of manufacture is expected to increase rapidly, exports of traditional primary commodities accounting for the bulk of exports of developing countries are expected to increase at an average rate of less than 4 per cent per annum during the period up to 1975.

4. Present indications are that by 1975 the commodity exports of developing countries as a group may range from $57 to $62 billion, the former figure corresponding to a low assumption for the rate of growth of developed countries (4.2 per cent per annum), the latter to a high assumption (4.7 per cent per annum).

5. Import requirements, on the other hand, are likely to continue to increase at a rate roughly proportional to the rate of growth of developing countries. At an average rate of growth of 5.2 per cent per annum for developing countries as a whole, commodity import requirements would amount by 1975 to $60 billion, while at a growth rate of 6.1 per cent per annum, commodity import needs would rise to $70 billion. This assessment of import requirements has been made in the light of the evidence of past years, and on the assumption that approximately the same rate of import substitution continues.

6. The net deficit on invisible items is expected to range between $0.4 billion and $1.9 billion in 1975. At the same time, taking into account both past and prospective debt accumulation and private capital inflow, net payments on account of investment income may reach a level of $12 to $14 billion by 1975.

[1] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 43.

[2] *Trade prospects and capital needs of developing countries* (United Nations publication, Sales No.: E.68.II.D.13) (TD/34/Rev.1).

7. Thus, the "trade gap" of developing countries, reflecting prospective payments and receipts on account of goods, services, and investment income, may amount, at 1960 prices, to between \$17 and \$26 billion in 1975, depending on the assumption made about the respective growth rates of developed and developing countries. It will be noted that nearly three-quarters of the "trade gap" is attributable to investment income on the low growth assumption, and more than half on the high growth assumption.

8. The trade gap thus estimated assumes the continuation into the future of the import and export trends observed in the past. It therefore provides a measure of the extent of domestic adjustments and additional external resources jointly required to sustain an adequate rate of growth. Clear action will be needed on both the domestic and the external fronts if the trade gap is to be bridged without cutting the growth targets of developing countries below sustainable levels. Such action may include additional efforts by developing countries to mobilize domestic savings, encourage import substitution, and develop and promote exports; and by developed countries to increase the flow of public and private capital to developing countries.

9. If one-half the burden of bridging the prospective "trade gap" were to be borne by official capital inflow, this would involve an increase of such inflow to some \$13 billion net by 1975, on the high growth assumption. It may also be anticipated that private capital inflow would rise to \$5 billion by 1975. The total required inflow of public and private capital would thus amount to \$18 billion net, which could be provided if developed countries implemented the 1 per cent assistance target.

10. If, however, external financial assistance should fail to increase adequately, and the purchasing power of total external resources (exports plus capital inflow) should continue to increase at less than 4 per cent annually, as seems likely in a considerable number of developing countries other than petroleum exporters, these countries will find it increasingly difficult to ensure economic growth at a satisfactory rate even if they further intensify their efforts to mobilize domestic resources, as they will no doubt wish to do in any case. For, even if their imports rose only in proportion to their income, on the average, there would be a constant tendency for import expenditure to run ahead of foreign exchange resources. The importance of adequate foreign exchange receipts in the process of economic development is also confirmed by the recent finding of the International Monetary Fund (IMF), according to which:

> "In almost all of the [developing] countries where total real output was rising rapidly from 1960 to 1965 — i. e., by 7 to over 10 per cent per annum — exports of goods and services were rising considerably faster, in some cases by as much as 15 to 20 per cent per annum or even more.[3]"

[3] IMF, *Annual Report of the Executive Directors for the fiscal year ended April 30, 1967* (Washington, D.C., 1967), p. 101.

(b) *Mobilization of domestic resources*

11. Important as it is to step up the flow of capital to developing countries, external assistance can only complement the effective mobilization of internal resources by the developing countries themselves. In this respect, although the over-all growth record of developing countries has been unsatisfactory in recent years, it appears from a secretariat study that, despite important failures and shortcomings (notably in the sphere of agriculture), developing countries on the whole are making more effective use of their own resources than they were some years ago and that their ability to use external resources productively has advanced accordingly.[4] Available estimates for fifty-four developing countries indicate that in as many as thirty-seven cases gross domestic capital formation amounted to 15 per cent or more of gross domestic product in 1963-1965. Taking the developing countries as a whole, the average annual investment rate increased from about 15 per cent of gross domestic product in the early 1950s to 17 per cent during 1963-1965. In a considerable number of countries real gross investment increased at an average annual rate of 7.5 per cent or more during the period 1950-1965.

12. Also relevant to an assessment of the developing countries' own efforts is the domestic savings rate. Domestic savings in developing countries have also been rising, although their growth would have been greater if many of these countries had not experienced adverse developments in the export sector. The developing countries as a group saved on the average about 14 per cent of their combined annual gross income in 1963-1965, as against 13 per cent during the early 1950s. Twenty-three out of the fifty-four countries for which data are available saved 15 per cent or more of their gross domestic product in 1963-1965. The marginal savings rate — the proportion saved out of increases in income — averaged about 15 per cent in the developing countries as a group during the period 1950-1965. As many as twenty-three out of the thirty-eight countries for which statistically significant estimates can be made had a marginal savings rate of 15 per cent or more during 1950-1965.

13. The secretariat study referred to above also found that a considerable number of developing countries have been successful in raising the proportion of income collected in taxes. However, because of an equally fast growth of current government expenditure the potential for public savings implicit in rising tax revenues has often not been fully realized. Of course, it must be borne in mind that some items of current expenditure, such as outlays on education and health, may be highly productive from the standpoint of promoting economic development. Moreover, even the most far-reaching

[4] See below "Mobilization of internal resources by the developing countries" (document TD/7/Supp.2), to be found in this volume. This conclusion parallels that reached by the Chairman of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD): "... the basic indicators of productivity and per capita income clearly record progress. To be sure, the rate is slow, but there is improvement over past levels and the records of the various individual countries show that acceleration is possible." (OECD, *Development Assistance Efforts and Policies, 1967 Review* (Paris, 1967), p. 32).

measures to increase tax revenues can be frustrated by declines in export earnings, which often provide a high proportion of the taxable income of a developing country.

14. Great concern attaches to the fact that *per capita* agricultural production in developing countries as a whole tended to stagnate in the 1960s. It is not entirely clear whether the adverse developments of the past few years represent a basic shift in the trend of production, or whether they are due rather to localized special situations which, however, have unfortunately affected some of the larger and most heavily populated countries. There are indications of a recovery of production in some of these countries. In any case, it seems evident that the pace of agricultural development needs to be accelerated and to that end both domestic efforts by developing countries (including effective programmes of land reform) and external resources for imports of fertilizers, equipment and other inputs will be required.

15. A country's economic performance is influenced by many factors, not all of which are amenable to government control. Thus, meaningful performance norms cannot be established without a detailed evaluation of structural characteristics, potentialities and constraints which condition the pace of development of each country. It would appear that an impartial expert evaluation of plans and performance on a continuing basis would help greatly in evolving an effective international development policy. Such a procedure would assure capital-exporting countries that the resources supplied were being put to good use without requiring them to set up their own evaluation machinery, a task for which only a few major countries are adequately equipped. At the same time, it would also help to foster the growth of the idea that the sole object of economic aid should be to promote economic development. If the principle involved in the above proposal were accepted, appropriate institutional arrangements could be worked out.

(c) *Supply of external assistance*

16. The greater efforts of developing countries to mobilize their own resources have unfortunately not been matched by an adequate increase in the total flow of external assistance. This has occurred even though the capacity of industrialized countries to provide financial resources for development has risen considerably during the Development Decade, owing to the very favourable growth record of these countries in recent years. It is for this reason that the representatives of forty-five governments, representing market economy, socialist and developing countries recently agreed unanimously that:

> " It is a matter of concern that the flow of financial resources from developed countries, in support of the developing countries' efforts, has failed in recent years to keep pace with the growth in the national incomes of the developed countries, even though most developing countries could immediately put into effective use a greater volume of external assistance. "[5]

17. The total flow of financial resources (net of amortization and capital repatriation) to multilateral agencies and developing countries declined in 1966. The net flow of capital to developing countries has been declining steadily as a proportion of the combined gross national product (GNP) of the developed market economy countries ever since 1961. A slight upturn in the ratio in 1965 was followed by an even sharper downturn in 1966; so that the average ratio of development assistance to the GNP of developed market economy countries as a whole dropped to only about 0.62 per cent in 1966.[6] In other words, the developed market economy countries have been moving steadily away from the aid target adopted by the General Assembly of the United Nations in 1960 and reaffirmed by the United Nations Conference on Trade and Development at its first session in 1964. In the socialist countries likewise the average annual increase in assistance commitments has been below 1 per cent of their gross income during the 1960s.

18. The shortfall in the flow of aid contrasts with the steady growth of GNP and government budgets in the developed countries. The gross income of all developed countries was almost $400 billion higher in 1966 than in 1961, while the total increase in the volume of assistance amounted to about $400 million.

19. In view of the very different nature and motivations of public and private capital flows, separate attention to each type of flow seems warranted. Private foreign investment is the result of private decisions and responds to normal profit opportunities. Consequently, while private capital flows may, under suitable conditions, play an important role in the development process, they do not constitute " aid " in the sense of resources supplied without commensurate return. They do not, moreover, respond as directly to government policies as do official flows. Thus, it would appear that, without detriment to the 1 per cent target, it would be desirable to have a target for official development assistance as a measure of the commitment of governments to international development.

20. Net official disbursements of aid normally account for only some 3 per cent or less of total government expenditure. Yet aid expenditures in the developed countries have on the whole lagged even further behind total government expenditure than behind GNP. Thus, even though government expenditures are rising, foreign aid is unsuccessful in competing even for a proportional share of the increase.

21. Ideally, it would be desirable that developed countries should establish adequate aid budgets and

[5] " Agreed statement on the problems of development ", adopted by the Committee on Invisibles and Financing related to Trade on 19 April 1967 (see *Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3* (TD/B/118/Rev. 1), annex II), section A, para. 1.

[6] This percentage relates to the net flow of capital, public and private, to the developing countries of Africa, Asia and Latin America, and includes the net change in guaranteed private export credits. If European recipients are included, the ratio rises to 0.69. If private export credits are excluded, the ratio falls to 0.56 in relation to the developing countries of Africa, Asia and Latin America, and to 0.60 in relation to all developing countries. See below " Growth and external development finance " document TD/7/Supp.1, to be found in this volume).

maintain them regardless of changing economic conditions. Aid should be regarded as one of the priority items in government budgets. Although one could not expect the flow of aid to be completely insulated from fluctuations in economic conditions, it seems necessary to ensure that aid does not bear more than its fair share of any needed adjustment.

22. Without prejudice to, and consistent with, the 1 per cent target, it would seem desirable that, as a minimum, the rate of increase of net official flows from each developed country should not fall below the rate of growth of its GNP. Countries whose net official assistance is currently below 0.75 per cent of their GNP might undertake to raise it to this level by, say, 1971.

23. A supplementary target, more directly related to the control exercised by governments over official aid allocations, would be that the net official flow from each developed country should be maintained, at the minimum, as a constant proportion of government expenditure. Details on net official flows in relation to gross national product and to budget expenditure are shown in table 1.

24. It is particularly important that administrations and legislatures should, in considering the flow of official aid, take account of the net, as well as of the gross, flow. In recent years, the return flow of interest and amortization on past lending has come to absorb an increasing proportion of gross aid flows to developing countries. However, in many countries, it is customary to consider budgetary expenditures on a gross basis without taking account of return flows on previous lending. Thus, the fiscal incidence of official assistance disbursements is not always clear to parliaments, with the result that the extent of the assistance burden is often much exaggerated. It may be helpful to emphasize the relationship between the gross and net flows and, indeed, to operate aid programmes on a revolving fund basis; a revolving fund mechanism would allow repayments of amortization and interest charges on past loans to be made available for fresh assistance to developing countries.

25. Finally, there are substantial opportunities for the expansion of arrangements between socialist and developing countries whereby capital equipment and other goods supplied on long-term credit by the socialist countries can be repaid in kind by the developing countries. Preliminary UNCTAD studies have shown a considerable growth in this form of co-operation in recent years and specific case studies are now in progress to elucidate the character and prospects of these arrangements, including the manner in which such problems as pricing policy and the additionality of exports by developing countries are and can be solved.

TABLE 1

Sixteen developed market economy countries: net official flows[a] as a percentage of GNP and total budget expenditure, 1965

Country	*GNP*[b]	*Total budget expenditure*[c]
Australia	0.52	2.87
Austria	0.40	1.44
Belgium	0.70	2.79
Canada	0.26	1.59
Denmark	0.08	0.47
Federal Republic of Germany	0.38	3.74
France	0.81	1.69
Italy	0.14	0.65
Japan	0.28	2.17
Netherlands	0.36	1.53
Norway	0.14	0.64
Portugal	0.49	...
Sweden	0.19	0.75
Switzerland	0.02	0.26
United Kingdom	0.45	1.43
United States	0.50	2.84

Sources: UNCTAD secretariat, based on: net official flows: see below document TD/7/Supp. 1 (to be found in this volume), table 2; GNP: United Nations, *Yearbook of National Accounts Statistics, 1965* (United Nations publication, Sales No.: 66.XVII.2); net official flows as a percentage of total budget expenditure: United Nations, "Factors affecting the ability of developed countries to provide resources to developing countries" (*Official Records of the Economic and Social Council, Forty-third Session, Annexes*, agenda item 5, document E/4375, table 8).

[a] Net official flows to recipient countries of Africa, Asia and Latin America and multilateral agencies.

[b] At market prices.

[c] The budget expenditure figures used in the calculation of ratios refer to those of the central government plus the net results of the current operations of government trading enterprises; they include transactions in goods and services, transfers and transactions in financial assets, but exclude transactions in financial liabilities. The budget figures for Australia, Sweden and the United States refer to fiscal years ending 30 June, and for Denmark and Japan to fiscal years ending 31 March. Data for total budget expenditures expressed in national currencies have been converted into United States dollars at the average annual exchange rate.

(d) *External assistance through multilateral institutions*

26. Special attention needs to be paid to the flow of aid through multilateral institutions. There is a wide measure of agreement that multilateral institutions can be particularly effective in supporting sound development programmes because they are in a position to take an objective view of such programmes and to base their decisions exclusively on development needs. A larger flow of aid through multilateral institutions would also have the advantage of reducing the proliferation of separate national aid administrations with all their attendant international overlapping, duplication and even conflict.

27. The situation with respect to multilateral aid, however, gives rise to the gravest concern. The excessive delay in replenishing the resources of the International Development Association (IDA) has been compounded by the inability of the International Bank for Reconstruction and Development (IBRD) to secure adequate access to capital markets. According to a recent statement by the Bank's representative at the fifth session of the Trade and Development Board, "... in recent times, governments have become more and more hesitant to allow the Bank to issue bonds on their market."[7] As a result, the Bank does not feel confident of its ability to raise the funds it needs in the next few years through the sale of its bonds. In order to reduce the IBRD's need for new bond issues, the Governors of the Bank decided

[7] Statement by the representative of the International Bank for Reconstruction and Development at the 13th meeting of the Sessional Committee on IBRD transfers to the International Development Association (Trade and Development Board document TD/B/SC.7/L.4).

in 1967 to allocate to Supplemental Reserves almost the entire current income for that year, with the result that even the small annual transfer hitherto made to IDA from the net income of the Bank was cut sharply. The replenishment of IDA has thus become a matter of the utmost urgency, as has the relaxation of the restrictions imposed on the flotation of bonds by IBRD.

28. The case for an increase in the resources of the regional development banks is equally strong. These banks could be particularly important and influential in mobilizing the development efforts of the beneficiary countries as a group and in providing material incentives for them to co-operate in schemes of regional development and integration. Financial support for regional co-operation through the regional development banks would undoubtedly facilitate a more economic and effective use of the domestic resources of the developing countries themselves, and encourage them to seek mutually consistent and complementary programmes of development.

29. It is important to envisage new ways in which capital markets may be made to yield a larger flow of resources to developing countries through the multilateral institutions. It is, moreover, not only a question of better access to national capital markets for the multilateral institutions but also of utilizing the rapidly growing facilities of the international bond market, in which a total of over $1 billion was raised in 1966. Preliminary estimates for the first half of 1967 indicate further significant expansion of the international bond market with new issues in 1967 probably approaching $2 billion.[8]

30. In this context the Horowitz proposal deserves further consideration. It will be recalled that this proposal envisages an international institution borrowing funds in the financial markets of the world on commercial terms and relending those funds, through the IDA, to developing countries at low rates of interest for a suggested period of thirty years. The difference between the cost to the institution and the low rates of interest would be covered by an "interest equalization fund" obtained through budgetary allocations of the developed countries and the allocation of some portion of the net income of the IBRD. Both the staff of IBRD[9] and a group of distinguished banking and financial experts appointed under the auspices of UNCTAD[10] have found that the proposal is technically sound provided that a separate system of joint and several guarantees by governments to IDA is established. One of the principal difficulties hitherto encountered in obtaining support for this scheme lies in the fact that some of the most highly developed capital markets are to be found in countries currently under the heaviest balance of payments pressure. Viewed in a longer perspective, however, the scheme has much to commend it as a means of overcoming the obstacles to the expansion of aid.

[8] It may be noted that in 1966 the European Investment Bank (EIB) received $40 million from public issues on this market, and arrangements for another $25 million issues were made in September 1967.

[9] IBRD, *the Horowitz Proposal — A Staff Report* (Washington, D.C., 1965).

[10] "The Horowitz Proposal; report of the Group of Experts" (Trade and Development Board document TD/B/C.3/23).

Chapter II

The terms of aid

31. Studies by the UNCTAD secretariat[11] show that if current gross flows of aid are maintained on present terms and conditions, the net flow will decline substantially over the coming years, and that even if the objective were merely to maintain the current net inflow, gross flows would have to increase considerably.

32. Specifically, it has been shown that if the gross inflow of grants and loans into developing countries were to continue at 1965 levels, and 1965 average terms and conditions were maintained, the total net inflow of grants and loans (net of interest and amortization) would decline from $5.9 billion in 1966 to $3.6 billion in 1975. On the basis of the same assumptions, net lending for developing countries as a whole would become negative by the year 1970, and thus begin to offset the flow of grants.

33. If, however, the net inflow of grants and loans is to be maintained at its 1965 level, and export credits were assumed to grow at a rate of 5 per cent annually, the gross inflow of grants and loans would have to rise from $12.2 billion in 1966 to $17.5 billion in 1975, assuming the continuation of 1965 terms and conditions of borrowing. Total debt service would in that case rise from $5.1 billion in 1966 to $ 10.4 billion by 1975. Payments of interest and amortization by developing countries other than petroleum exporters at the end of the period would absorb an average of 23 per cent of their over-all export earnings, even assuming an average growth rate of exports of 4 per cent per annum.[12] Moreover, if lending were to continue on present terms, by the year 1975, 60 per cent of the gross inflow of grants and loans would be offset by debt service as opposed to 42 per cent in 1966 (see table 2).

34. Prospects would be substantially improved if all official lending were to take place on soft terms similar to those granted by IDA. The required gross inflow would then only have to rise to $14 billion by 1975 to maintain the 1965 net inflow; and debt service would increase to $6.9 billion. Additional improvement would require a rise in the proportion of grants in total gross flows.

35. These findings highlight the need to achieve a substantial softening of the terms of loans as well as an increasing proportion of grants in the total flow of aid. In resolution 2170 (XXI) the General Assembly of the United Nations recommended that "not later than 1968", at least 80 per cent of assistance should be in the form of grants, together with loans at interest rates of 3 per cent or less, with a repayment period of twenty-

[11] See in particular "The outlook for debt service" (document TD/7/Supp.5) and "The terms of financial flows and problems of debt servicing" (document TD/7/Supp.3, to be found in this volume).

[12] Exports of developing countries of commodities other than petroleum and manufactures are expected to increase at an average rate of less than 4 per cent per annum during the period up to 1975 (*Trade prospects and capital needs of developing countries, op. cit.*).

five years or more; except that where countries provide 70 per cent or more of their total official assistance in the form of grants or grant-like contributions, this in itself should be regarded as full compliance with the target. Similar recommendations were made by the Development Assistance Committee of OECD in its 1965 recommendation on the terms of aid.[13]

36. While a number of developed countries now comply with some or all of the objectives of these recommendations, the over-all statistical record is still extremely unsatisfactory. In many respects, the terms of assistance in 1966 compared unfavourably with those prevailing in the early 1960s. Grants have continued to decline as a percentage of gross official disbursements, falling steadily from a high of 80 per cent in 1960 to 58 per cent in 1966. Interest rates, maturities and grace periods of official bilateral loans, after a considerable hardening in 1965, softened somewhat in 1966 but this was probably offset by a hardening in the terms of lending from private sources. Moreover, repayment by developing countries on account of interest and amortization continues to absorb 45 per cent of official bilateral lending.

37. It is therefore of the utmost importance that the targets for softer terms adopted by the General Assembly of the United Nations and by DAC should be achieved, as indicated, not later than in 1968. It is also important to consider a further easing of terms beyond the United Nations/DAC target, since even compliance with this target would probably not avoid the development of a critical situation in a number of countries in the relatively near future. This could be achieved through agreement on a new target for terms, which would go beyond the United Nations/DAC target. Such a new target might specify, for all developed countries:

(a) the minimum percentage of official assistance to be given in the form of grants; and

(b) a separate minimum percentage of loans to be given on easy terms, namely, at interest rates of 3 per cent or less, maturities of twenty-five years or more and grace periods of at least seven years.

The only alternative would be a rate of increase in gross flows for which many developed countries do not seem to be prepared at the present time. Apart from increasing the share of grants in the total flow of aid, and softening the terms of loans still further, developed countries and multilateral institutions could assist developing countries by not requiring debt-service payments to begin until projects have been completed.

38. Whether or not the Horowitz proposal is itself acceptable, various forms of interest subsidies are possible. Clearly, budgetary funds can be provided at any rate of interest below the market rate, or without interest, or even without repayment obligations. This is shown by the variety of forms of interest subsidization which national as well as international institutions have used extensively in the past. Thus, some developed countries have subsidized interest charges on their export credits and development loans. Some countries have gone even further by initiating the practice of interest-free loans. An element of interest subsidy has also been present in the practice of some international lending agencies. For example, EIB, which relies partly on funds from the capital market, has the authority to grant to the associated States of the European Economic Community (EEC) interest rebates on loans. The amount required for this purpose is charged to the European Development Fund (EDF), which in turn is also empowered to make loans at concessionary rates of interest to associated States.

39. Harmonization of terms and conditions of assistance by developed countries is almost as important as the softening of terms. This is because, as in the case of aid tying, the less liberal policies of some developed countries exert pressure on the more liberal policies of others. It is therefore vital to narrow the spectrum of rates and maturities, particularly by improving the performance of the least liberal countries.

Chapter III

Problems of indebtedness

40. The discussion under chapter II above has indicated that the problem of indebtedness, which has already reached critical proportions in a number of developing countries, is likely to spread to many others within a relatively short period ahead if the volume and terms of aid are maintained at present levels. There is a widespread impression that the problem of indebtedness is highly concentrated in relatively few developing countries, facing difficulties either because of an excessive accumulation of debt (particularly short-term debt on hard terms) or because of a sudden reduction in the capacity to service debt due to unfavourable developments in foreign exchange receipts. There is growing evidence, however, that experience to date can serve only as a warning of a much broader and more widely diffused problem resulting from the inappropriateness of the terms of aid, and from the pressure upon developing countries to seek suppliers' credits to make up for the shortfall in the volume of aid.

41. While there are undoubtedly cases in which economic mismanagement in developing countries has been a principal or contributing cause of difficulties there appear to be other basic factors at work also. All types of capital inflow should, of course, ultimately generate the foreign exchange earnings or savings necessary to service the debt. But debt-service capacity does not necessarily grow at the same rate at which repayments fall due, especially where no deliberate effort has been made in advance to ensure a correspondence between the terms of loans and the country's capacity to repay. Because of the interdependence of projects, moreover, new investment may, in the short run, increase the pressure of development needs upon the balance of payments instead of reducing it. There is thus a danger that interest and repayment obligations may build up faster in the short and medium term than the capacity to release foreign exchange to meet these obligations. As

[13] See OECD, *Development Assistance Efforts and Policies — 1965 Review* (Paris, 1965), annex B.

TABLE 2

Developing regions:[a] *Projected estimates of gross capital inflow and debt service, 1966-1975 corresponding to a constant net inflow of resources*[b]

($U.S. billions)

	Africa			Asia and Middle East			Latin America			Total[d]		
	1966	1970	1975	1966	1970	1975	1966	1970	1975	1966	1970	1975
1. Net capital inflow[c]	2.3	2.3	2.3	3.5	3.5	3.5	0.8	0.8	0.8	7.1	7.1	7.1
2. Gross capital inflow	3.1	4.1	4.9	4.9	6.0	6.7	3.0	3.3	4.0	12.2	14.9	17.5
3. Total debt service	0.8	1.7	2.6	1.4	2.5	3.2	2.3	2.5	3.2	5.1	7.8	10.4
4. Debt service as percentage of gross capital inflow	26	43	53	29	41	48	75	77	81	42	52	60
5. Debt service as percentage of exports, assuming that exports grow at 4% per annum[e]	11	20	25	12	18	19	23	21	22	16	21	23

Source: UNCTAD secretariat, "The outlook for debt service" (document TD/7/Supp. 5, to be found in this volume).

[a] Countries included in various regions are listed in TD/7/Supp. 5, table 1.

[b] The net inflow of resources is held constant at the 1965 level and the composition and terms of net inflow are also assumed to be the same as during 1965 except that suppliers' credits are assumed to grow at an annual rate of 5 per cent.

[c] Grants and lending net of amortization and interest payments.

[d] Including European developing countries.

[e] Excluding petroleum exporters.

noted earlier, payments of interest and amortization by developing countries other than petroleum exporters are expected to absorb an average of 23 per cent of over-all export earnings by 1975, even assuming an average growth rate of exports of 4 per cent per annum (see table 2). It is quite possible, therefore, that a significant number of countries would by that time be having to set aside one-third or more of their export earnings for the service of debt. The vulnerability of such countries to declines in export prices or earnings is obvious. In addition, import needs are likely to rise as development proceeds. Many developing countries are thus very likely to be confronted with a situation in which a greater and greater proportion of export earnings will be tied to debt service, while at the same time import needs will constantly be increasing.

42. While a softening of terms may lead to a gradual easing of the situation in the long run, this cannot prevent a massive accumulation of debt-service obligations in a number of countries during the next few years; in these cases, only deliberate and planned rescheduling can avoid the onset of debt crises.

43. The present process of rescheduling is very complicated and time-consuming, and gives rise to a good deal of uncertainty, tending to disrupt not only trade and payments but the inflow of capital and, indeed, the whole development process. Present rescheduling techniques are deliberately informal because of the understandable desire of creditor countries to avoid excessive recourse to rescheduling operations. Under current procedures, moreover, the end result is merely a general agreement between the creditors and the debtor country seeking relief, while the specific application of the general agreement has to be worked out through complicated bilateral arrangements between individual creditors and their respective debtors. Finally, arrangements of this type have hitherto tended to provide only a breathing space for the debtor country concerned, so that the crisis is postponed but not dissipated, and the debtor country continues to operate under the persistent threat of balance-of-payments pressure.

44. Experience therefore suggests the need for more deliberate anticipation of crisis situations. The adoption of an early warning system within an appropriate institutional framework would make it possible to take appropriate steps before the onset of debt crises compels resort to unnecessarily drastic measures. Moreover, rescheduling criteria and procedures should not interfere with the orderly process of development planning in debtor countries, and should be systematically designed to prevent longer-term disruption of plans. For those debtor countries whose indebtedness problems are not of a strictly short-term nature but reflect structural imbalance, grace periods applying to amortization and interest payments on rescheduled debt should not be less than, say, seven years.

Chapter IV

The tying of aid

45. In addition to the adverse effects of the developments discussed above concerning the volume and terms of external assistance, the recent increase in the practice of tying aid to purchases from the capital-exporting country has tended to reduce the efficiency of the assistance and its beneficial influence on economic growth in recipient countries. More developed countries now apply procurement restrictions than at the beginning of the decade, and to a larger proportion of their aid. The balance-of-payments difficulties of some developed countries loom large among the reasons for this heightening of procurement restrictions. Tied aid practices have not been limited, however, to countries faced with balance-of-payments deficits, for other countries have increasingly tied their assistance as a competitive reaction to protect their own favourable payments situation.

46. While, in existing circumstances, tying may permit the total volume of aid to exceed the level it would other-

wise attain, a given amount of tied aid is less valuable and less effective than a corresponding amount of untied aid. In particular, the tying of aid narrows the recipient country's choice regarding the most suitable and least costly sources of supply. In so far as tied aid has to be repaid in convertible currency, the value repaid exceeds the value received, and the effective rate of interest is therefore substantially higher than the nominal rate. Moreover, while the tying of aid creates pressure favouring increases in the exports of the lending country, no equivalent pressure is thereby exerted in the repaying country. Finally, the tying of aid has indirect costs which are no less real for being difficult to quantify.

47. The secretariat is conducting a series of case studies on the tying of aid with a view to appraising its effects. While the full results of these studies are not yet available, it is already clear on the basis of preliminary findings that tying quite considerably reduces the value of aid to recipients and has only a modest favourable impact on the balance of payments of the aid-giving country. It can be stated that the direct costs alone account for at least one-sixth (at a very conservative estimate)[14] of the amount of aid which is tied; thus, on the reasonable assumption that in 1965 about three-fourths of total bilateral aid was tied in one form or another, the actual direct costs of tying probably amounted to about $1 billion.[15]

48. Consideration should be given to halting and reversing the trend towards increased tying of aid, especially since it is apparent that tying is a cumulative and mutually frustrating process, in which action by one aid-giving country is likely to lead to corresponding reaction by others. While it should be recognized that in the situation that now prevails a decision to untie all aid would involve difficulties to some developed countries, it may be possible to envisage a gradual approach towards this objective through a liberalization process analogous to that undertaken by the countries members of the former Organisation for European Economic Co-operation and Development in freeing their trade with one another. For this purpose, target percentages of liberalization could be established, to be realized by all aid-giving countries in parallel by a certain date. However, countries in balance-of-payments difficulties could be permitted to slow down their rate of liberalization during the period of such difficulties.

49. Moreover, in accordance with the agreement already reached in DAC in 1965 all developed countries should permit aid funds to be freely used for imports from developing countries.

50. The costs of tying aid to a particular source are all the greater, the less competitive is the aid-giving country in the production of the commodities which it regards as eligible for procurement under its aid programme. Aid should therefore be tied only in those cases where the difference between an aid-giving country's delivered price and the lowest delivered price available from third countries is not an excessive one. A maximum price differential of, say, 10 per cent should be considered. Where the differential exceeds 10 per cent, the onus should be on the aid-giving country either to add to the eligible list of products needed by the recipient which the aid-giving country can supply at less than 10 per cent above world market prices, or to permit procurement from a competitive supplier in another country.

51. The disadvantages of tied aid could thus be mitigated if recipient countries were given freedom to choose from a substantial range of goods and services from one source. Aid should in any case not be tied simultaneously by source and commodity, this being the most costly form of tying for recipient countries.

52. To the extent that countries continue to tie their aid, they should assume responsibility for checking the prices of goods supplied so as to avoid excess costs to recipient countries; and should undertake to offset costs in excess of those prevailing in the world market, especially since such offset payments to domestic suppliers in local currency would not create any pressure on the balance of payments.[16]

Chapter V

Difficulties of aid administration

53. The secretariat has under study the problems arising in the administration of aid programmes that lead to serious delays and uncertainties. It is already clear that major difficulties arise from the fact that the requirements of aid-giving countries and multilateral institutions vary considerably from one to the other. Cases have thus arisen in which developing countries, having gone to great trouble and expense to prepare projects in a form acceptable to one aid-giving country, find that the project has to be completely recast before presentation, in case of need, to another country. Consequently, while aid-giving countries are not prepared to commit funds except on the basis of fully worked-out projects, recipients are reluctant to incur the heavy expense of full-scale project preparation in the absence of some indication that finance will be available.

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[14] There is reason to believe that the excess direct costs of tying are in fact considerably higher. For a sample of international bids tabulated from IBRD and IDA data, the percentage of potential excess costs (measured as the ratio of the difference between high bids and successful bids to successful bids) averaged 49.3 per cent, and over 60 per cent of the value of contracts awarded was characterized by potential excess cost of over 30 per cent. See J. Bhagwati, "The tying of aid" (document TD/7/Supp.4, to be found in this volume).

[15] In a recent statement ("Multilateral and bilateral aid", address to the International Parliamentary Conference on Development Aid, Bonn, 7 April 1967) Mr. George Woods, President of IBRD, estimated the excess costs of tied aid on gross official bilateral disbursements by DAC member countries at around $1 billion, a figure of a magnitude similar to the estimate above. According to Mr. Woods, such an amount would have been sufficient to cover all of the repayments of principal due from the developing countries on official debt to the creditor countries of DAC in 1965.

[16] A precedent is to be found in the offsetting by the United States of the excess cost of freight resulting from the obligatory use of United States ships for deliveries under Public Law 480.

54. On the other hand, aid-giving countries encounter difficulties resulting from a lack of adequate preparation of assistance requests in terms of the economic priority, technical feasibility and financial viability of projects, and of the institutional capacity to handle them. Consequently, considerable delays may occur because of administrative shortcomings in the recipient countries themselves.

55. It would appear that considerable progress could be made if the requirements of aid-giving countries and institutions could be expressed in standardized form and if technical assistance could be provided to developing countries to improve the handling of aid applications. The secretariat has issued a questionnaire designed to elucidate the nature of the differences between the requirements of various developed countries and it is hoped that the analysis of responses will throw some light on possible action to be taken.

Chapter VI

Commercial credits, including suppliers' credits

56. Studies by IBRD and the United Nations Department of Economic and Social Affairs[17] have shown that while commercial credits play and important and useful role in world trade, excessive reliance on these credits may lead to debt-service crises and has, in some cases, already done so. There are many instances in which developing countries have accepted suppliers' credits which were characterized not only by very short maturities and high nominal interest charges but also by substantial over-pricing of the goods supplied, so that extremely high effective interest charges were in fact incurred. It has been suggested, on the one hand, that developing countries ought not to accept suppliers' credits on such terms, notwithstanding the heavy pressures to do so where official aid is not forthcoming in sufficient quantity. It has equally been contended, on the other hand, that the developed countries cannot legitimately escape responsibility for preventing the worst excesses involved in the system of commercial credits, especially since the primary object of such credits is not to aid developing countries but to encourage the marketing of exports.

57. Consideration should be given by developed countries to a more effective surveillance of the conditions on which commercial credits are granted and the prices at which goods are supplied, as well as to the possibility of interest subsidies ; by developing countries to a more careful checking of offers of commercial credit and comparing of offers available from a variety of sources ; and by the multilateral lending institutions to the provision of technical assistance in the interests of avoiding the unfavourable features of commercial credits. National and international institutions should also co-operate actively in the collection, elaboration and dissemination of information on the terms and conditions of commercial credits.

Chapter VII

Private capital

58. Studies of the flow of private capital to developing countries[18] have shown that private investment can play an important role in promoting the growth of developing countries both by adding to the resources available for the expansion of productive capacity in these countries and by facilitating the transfer of technology and know-how.

59. Potential recipients have frequently sought to regulate the conditions for the entry of private foreign capital for a variety of reasons. These include a desire to retain control over strategic sectors of the economy as well as to limit pressures on the balance of payments due to large transfers of profits or repatriation of capital, which may cause problems analogous to those resulting when excessively hard terms are applied to the provision of public capital. The problem has been to devise the type of policy which is needed to secure the goals of the developing countries without thereby creating obstacles so great as to destroy incentives to the foreign investor.

60. While no simple prescription is available for effecting this reconciliation of objectives, certain types of action have shown promising results. It is particularly important to provide for the greatest possible participation of local capital as well as of local labour and management. It may also be helpful to provide, wherever possible, for a gradual transition from predominantly foreign to predominantly local ownership and control.

61. Regarding international measures to encourage private investment in developing areas, a plan for a multilateral investment insurance scheme has been prepared by OECD and submitted to IBRD. The scheme seeks to facilitate the flow of private capital to developing countries by providing guarantees against risks of a non-commercial nature. By spreading the risk-bearing among a large group of countries, the scheme would probably encourage the flow of private capital from countries which do not at present play an important role in this field. As such, the scheme would warrant careful consideration by governments.

62. In addition, under the auspices of IBRD, a Convention on the Settlement of Investment Disputes between States and Nationals of other States came into effect on 14 October 1966. The Convention has established an International Centre for the Settlement of Investment Disputes as an autonomous institution for the conciliation or arbitration of disputes directly between foreign investors and host governments. The Convention provides for voluntary recourse to the Centre, and for arbitration under agreed rules.

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[17] IBRD, *Suppliers' Credits from Industrialized to Developing Countries* (Washington, D.C., 1967), and United Nations, *Export Credits and Development Financing* (United Nations publication, Sales No. : 67.II.D.1).

[18] See, for example, United Nations, *Foreign investment in developing countries* (United Nations publication, Sales No. : E.68.II.D.2).

Chapter VIII

Compensatory finance

63. Responding to recommendation A.IV.17 of the Conference at its first session,[19] the International Monetary Fund (IMF) recently liberalized its compensatory financing facility, enlarging the scope and increasing the flexibility of the system.[20] Partly for this reason and partly also because of less favourable trends in commodity prices, a larger number of developing countries had recourse to the IMF facility in 1967 than in previous years.

64. Substantial limitations on the scope of the facility remain. Although the amount of drawing rights available has now been increased from 25 per cent to 50 per cent of quota, not more than 25 per cent of quota may normally be drawn in any one year, and drawings in excess of 25 per cent of quota are subject to more stringent conditions than those falling within the first 25 per cent. The three- to five-year period of repayment has been retained irrespective of the course of export earnings, although once the repayments have been made, countries become eligible for new drawings. Finally, it was not found possible to follow paragraph 2 of recommendation A.IV.17 of the Conference ot its first session to the effect that in the determination of the shortfall in export receipts, greater weight should be given to the actual experience of the three preceding years.

Chapter IX

Supplementary financial measures

65. The IBRD staff scheme on supplementary financing was prepared in accordance with recommendation A.IV.18 of the United Nations Conference on Trade and Development at its first session.[21] The purpose of the scheme is the provision of longer-term assistance to developing countries for avoiding disruption of sound development programmes endangered by adverse movements in export proceeds which prove to be of such a nature and duration that they cannot be adequately offset by short-term balance of payments support.

66. The IBRD scheme provides for prior agreement between a member country and the agency administering the scheme, on export projections, development programmes and policies, and feasible domestic adjustments to offset export shortfalls. If the agency determines that a country is acting within the framework of such an agreement (called the "policy package") and if actual exports are lower than pre-agreed projections, there is a *prima facie* claim for assistance under the scheme.

67. This scheme has been under active consideration by an inter-governmental group in UNCTAD. In the course of its examination, the Group has identified some major issues raised by the proposal on which decisions are required.[22] The IBRD scheme is based on the assumption that the necessary finance will be wholly supplementary to, and not a substitute for, existing aid programmes; thus, if the scheme is to serve its basic purpose, the financial resources needed for its operation would have to be genuinely additional. Another basic issue relates to the degree of discretion to be given to the agency administering the scheme. The IBRD scheme is not intended to be automatic in its operation. Rather, a considerable element of discretion is built into it, but the discretionary authority of the administering agency is to be exercised within a framework of objective and well-defined criteria. The essential issue is therefore whether the criteria can be defined in such a way as to permit adequate flexibility in the operation of the administering agency, while meeting the need to ensure that assistance should be provided promptly and certainly once requirements have been met.

68. Other important issues requiring decision are:

(a) The content of the "policy package";

(b) The validity of basing financial compensation on export projections;

(c) The method of calculation of export shortfalls;

(d) The treatment of overages (excess of actual exports over projected exports) as an offset to future export shortfalls within a given plan period;

(e) The relationship of the IBRD scheme to IMF;

(f) The form and terms of assistance;

(g) The cost of the scheme and the nature and extent of donors' commitments.

69. In relation to the "policy package", the major issue is that of the extent of its comprehensiveness. The IBRD staff scheme provides for a policy package which would cover the entire development programme and policies, including the foreign trade policies of member countries. Many developing countries regard such a "policy package" as too complex. It is agreed that export projections and policies must form an essential part of the initial policy understanding. However, in so far as a member's development programme and related policies have an important bearing on export performance, there should be no objection to bringing them within the scope of the policy package. It should, however, be understood that the requirements of the policy package would not go beyond the kind of inquiries and understandings now customary in consortia and consultative groups.

70. Concerning the question of the validity of basing financial compensation on export projections, the inherent uncertainty of the future makes it likely that pro-

[19] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 52.

[20] See IMF, *Compensatory Financing of Export Fluctuations: Developments in the Fund's Facility* (second printing, Washington, D.C., 1967).

[21] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 52.

[22] See "Intergovernmental Group on Supplementary Financing: report on its second session" (Trade and Development Board document TD/B/C.3/44).

jected and actual values of exports will often diverge. However, it must also be noted that export projections are an essential component of a development plan and that the very uncertainty of export prospects is the justification of the scheme.

71. The question of the frequency and extent of the revisions of export projections and of the development programme is also an important one. It is in the interest of developing countries that adjustments in response to changes in fundamental trends should not be resisted. However, frequent changes in the export projections and in the development programme will defeat the very purpose of the scheme. While there should be no objection to the re-orientation of investment priorities if so demanded by considerations of basic comparative advantage, the size of the development programme itself should not be revised, save in very exceptional circumstances. Revisions should be undertaken by mutual agreement between the agency and a member government on the proposal of either party, where both parties agree that unforeseen developments make such revision necessary.

72. So far as possible, and depending on the availability of reliable data, export shortfalls should be calculated in real terms, i.e. after adjusting for the effects of an unexpected increase in import prices.

73. The Bank staff scheme provides that when a country records an overage (excess of actual exports over projected exports) in one or more years, the administering agency may require that any shortfall occurring in a subsequent year of the projection period be reduced by the amount of such overage or overages, provided that net overages of one projection period, if any, should not be carried over to the next projection period. However, it is also possible to conceive of other legitimate uses of overages, for example, to finance an unexpected increase in essential imports, or to finance projects originally scheduled for a later date. In such circumstances, the agency should be prepared to entertain requests from member governments to disregard overages in cases where the latter had been used to rebuild gold or foreign exchange reserves to an adequate level, to accelerate or expand sound investment programmes, or for other purposes consistent with the pre-agreed development programme.

74. The view of the IMF staff appears to be that by guaranteeing a certain level of export proceeds on the basis of export projections determined up to five years in advance, the IBRD scheme might interfere with, or unduly delay, the smooth process of adjustment to adverse external factors. The Bank scheme might thus imply an attitude towards balance of payments adjustment which would be different from that of the Fund. The Fund staff is therefore concerned about the possibility that a country may receive conflicting advice from the Fund and from the agency administering the Bank scheme. There is also a fear that the authority which the Fund derives from being the sole residual source of finance may be undermined by having to share that residual fonction with a supplementary financing agency. It appears however, that the views of the IMF staff and of the IBRD staff are by no means as incompatible as thus implied. The Bank scheme does not rule out the need for adjustment to external circumstances during the planning period : for example, the scheme specifically calls for feasible cuts in non-essential consumption and imports as the first means of offsetting an export shortfall. By focusing the adjustment mechanism on non-essential consumption and imports, the Bank scheme has the merit of allowing the country to avoid being forced into cuts of developmental imports and of planned investment. Also, the possibility that a country might receive conflicting advice from IMF and from the administering agency could be dealt with by writing into the Articles of Agreement of the proposed scheme a provision for effective advance consultation with IMF on all matters falling within the latter's jurisdiction. In addition to consultations as the time of the initial policy package, the administering agency might also be required to consult with the Fund regarding the extent to which an actual export shortfall might be dealt with by recourse to alternative sources of finance, including the use of the country's gold and foreign exchange reserves as well as the existing compensatory financing facility of the Fund.

75. Consistent with the provisions of recommendation A.IV.18 adopted by the Conference at its first session, the terms of loans provided by the agency should be adjusted to the economic position and prospects, including debt-servicing capacity, of the member country concerned.

76. Developed countries cannot be expected to accept an open-ended commitment in relation to the Bank scheme. Accordingly, it would be necessary to limit the scope of the scheme from the outset to amounts which donor countries would agree to make available. However, it must be emphasized that the amount of resources made available to the scheme must bear some relation to its basic purposes. Considering all relevant issues, the Bank staff estimate of $300-$400 million per year seems to offer a realistic basis for initiating the operation of the scheme. If the administering agency is faced with a situation where the aggregate level of export shortfalls eligible for financing during any year is likely, in the agency's view, to exceed the financial resources at its disposal, provision should be made for establishing an equitable system of rationing its resources.

77. The IBRD scheme attempts to fill a genuine and important gap in the existing international financial machinery which at present does not include mechanism designed to deal with the disruptive effects of unexpected export shortfalls. Provided that the resources made available to the scheme are truly additional, it would prove a valuable complement to the existing machinery of international economic co-operation.

Chapter X

International monetary issues

78. It is now generally agreed that the traditional means of adding to world reserves under the present system cannot by themselves provide adequate growth of reserves needed in an expanding world economy. Deve-

loping countries have a great stake in an international monetary reform based on the principle of universality[23] not only because of their own pressing needs for liquidity but also because their massive trade gap, which has aroused so much concern in UNCTAD and elsewhere, can only be bridged in the environment of a vigorous expansion of the world economy. This expansion in turn is greatly dependent on the adequacy of international liquidity. A world where competition for reserves is so widespread as to stand in the way both of full utilization of the world's productive resources as well as of liberalization of trade and payments does not provide an environment conducive to satisfactory growth of developing countries. Great importance is thus to be attributed to the current negotiations in the Fund, which have resulted in an agreed outline of a contingency plan for deliberate reserve creation. Since many symptoms of the shortage of liquidity are now present in the world economy, it is hoped that the activation of the contingency plan will not be unduly delayed.

79. Now that agreement has been reached on a scheme for the creation of a new form of international monetary reserve, renewed consideration should be given to the implications of this decision for the flow of aid to the developing countries. Balance of payments difficulties have been cited by some of the main aid-giving countries as a major obstacle to the expansion of aid. Even surplus countries have been reluctant to add to their aid commitments, some in the belief that their surpluses were a temporary phenomenon, some from a desire to add to their foreign exchange reserves or to protect the attained level of reserves.

80. In so far as the creation of new reserves eases the process of international balance of payments adjustment, it creates a presumption that the flow of aid could be increased likewise. This would be true whether or not such an increase in the flow of aid were organically linked to the process of reserve creation. While there are important advantages in an organic link, the requirements of the situation could equally well be met if a convention were adopted whereby activation of the contingency plan and successive acts of international liquidity creation would be accompanied by voluntary contributions to IDA by all the part I member countries of IDA — the size of the voluntary contribution being a certain uniform proportion of the share of each part I country in international liquidity creation. By these means, it would be possible to secure generous replenishment for IDA from time to time without any fear that some countries might stand to lose reserves as a result of their contributions to IDA—a fear that has played a major part in the current delay in IDA replenishment.

[23] This principle was unanimously accepted in General Assembly resolution 2208 (XXI) of 17 December 1966.

TERMS AND CONDITIONS OF EXTERNAL DEVELOPMENT FINANCE

DOCUMENT TD/7/SUPP.1

Growth and external development finance
Study by the secretariat of UNCTAD

[Original text: English]
[17 October 1967]

Summary and proposals

1. Thus far during the United Nations Development Decade there has been virtually no improvement in the over-all rate of growth of the developing countries and a deterioration in the growth of income per head. Progress toward the 5 per cent target rate of growth for the Development Decade will therefore require a marked acceleration in the pace of economic development. This will call for greater efforts by these countries in mobilizing their own resources, as well as for considerable increases in the inflow of external resources.

2. The outlook is not bright for continued and substantial increases in the net flow of financial resources during the remainder of the Development Decade. Only if the development assistance programmes of the major countries are increased considerably in scale and if efforts to expand substantially the operations of multilateral agencies succeed, may it be hoped that a significant addition to the net flow of external development finance will occur.

3. The total flow of financial resources (net of amortization and capital repatriation) from the developed market economy countries to recipient countries of Africa, Asia and Latin America and to multilateral agencies fluctuated around an average level of about \$8.5 billion during 1960-1966, rising to a high of \$9.7 billion in 1965 but falling back to about \$9 billion in 1966. Over the same period there was a rapid expansion in the operations of the multilateral agencies. Their expanding disbursements of development finance offset to a certain extent the fluctuations occurring in official bilateral and private flows to recipient countries.

4. Total official economic assistance (net of amortization) from developed market economy countries to recipient countries and multilateral agencies averaged \$5.6 billion a year during the 1960s. The average in the first two years following the first session of the United Nations Conference on Trade and Development was \$6 billion a year.

5. It is difficult to discern any clear pattern of distribution of capital flows among recipient countries in terms of economic criteria. Governments often concentrate their aid upon countries with which they have affiliations of one kind or another. Private capital concentrates largely upon countries that are already, or are potential, exporters of petroleum and, to a lesser extent, of other minerals. The net result of this concentration is a somewhat haphazard distribution of the total resources available, and a tendency for the per capita flows to the low-income countries to be below the average.

6. Increasing service and investment income payments, and unfavourable price movements are tending to reduce the transfer of resources to developing countries. In 1965-1966, for example, interest and amortization payments by these countries absorbed some 45 per cent of gross lending by countries members of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD).

7. Private capital flows (net of amortization and capital repatriation) to developing countries and multilateral agencies underwent marked fluctuations over the period 1956-1966. In 1966 net private flows were about 20 per cent lower than in 1965, at about the average for 1960-1964.

8. Commitments from the socialist countries of eastern Europe and Asia to developing countries fluctuated considerably in the 1960s. The 1965-1966 average was approximately 41 per cent above the average for the period 1960-1964. Estimates of the gross disbursements by the socialist countries to developing countries put the total at about \$300-\$500 million a year in the 1960s.

9. The capacity of developed countries to provide financial resources to developing countries and multilateral agencies has risen greatly during the Development Decade but very little of the substantial increases in the gross output of these countries has been devoted to the assistance of developing countries. The average total outflow of capital (net of amortization and capital repatriation) in 1965-1966 from developed market economy countries amounted to only 0.68 per cent of their aggregate gross national product (GNP) compared with the 0.87 per cent of GNP achieved in 1961. In the socialist countries new assistance commitments have on average been below 1 per cent of their gross output during the 1960s.

10. Thus, achievement of the 1 per cent target for the flow of financial resources adopted by the General

Assembly and reaffirmed by the United Nations Conference on Trade on Development at its first session is more remote now than it was at the outset of the Development Decade. Although some developed countries have made notable progress towards the achievement of this goal there has clearly not been a sustained drive on the part of all countries to achieve the target before the end of the Decade.

11. The inadequacy of current aid flows is often attributed to balance of payments problems and budgetary difficulties facing some major countries. However, the balance of payments argument for reduced aid programmes has lost its validity owing to widespread tying of aid, in particular in the deficit countries, and the problem is essentially one of the degree of priority assigned to aid programmes in economically advanced countries. Because of inadequate appreciation on the part of public authorities of the significance of development assistance, aid has often come to be regarded as a residual element of government expenditure. Every effort should be made, therefore, to demonstrate to legislative and governmental bodies the importance of development assistance programmes.

12. The total development assistance effort of a developed country is commonly assessed in terms of the ratio of official and private outflows to its GNP, but not all the components of these outflows are equally responsive to governmental action.

13. There are limits to the effectiveness of government attempts to influence the magnitude and direction of private capital. It is desirable that means be established for the evaluation of official development assistance programmes independently of the performance of the private sector, and without prejudice to the 1 per cent target applicable to total private and official flows, net of amortization and capital repatriation.

14. A feasible goal for official development assistance programmes would appear to be that, as a minimum, the rate of increase of official flows to recipients and agencies, net of amortization, from each developed country should not fall below the rate of growth of its GNP. This would not be sufficient to ensure progress towards harmonization of the relative contributions of various countries. To achieve such harmonization it might be further recommended that a developed country's official net flow to developing countries and multilateral agencies should increase more rapidly than its GNP in those cases where the ratio of net flow to GNP was less than three-quarters of 1 per cent. Progress towards harmonization would be stimulated by setting a time limit for the fulfilment of the target, say 1971.

15. Without prejudice to the 1 per cent target or to the goal for official net flows suggested above, another goal for official net flows could be a target for official assistance in relation to the government expenditure of each developed country, stipulating, for example, that aid expenditure should increase at least as fast as total government expenditure.

16. A means of meeting the difficulties now faced in increasing the size of budgetary allocations for development assistance would be to operate aid programmes on a revolving fund basis, so that payments of interest and amortization would become available for new transfers to developing countries.

17. In the past the establishment, or expanded activity, of multilateral agencies has called forth increased efforts by economically advanced countries. It is of the greatest importance to expand the resources of these agencies, particularly the International Development Association (IDA) and the regional financing institutions. The delay in the replenishment of the resources of IDA is bound to have serious effects on the flow of finance to developing countries, and on the average terms at which assistance is provided; and early action on this matter is therefore vital. The regional financing institutions also deserve strong support, since they can be particularly effective in enlisting the best efforts of groups of recipients in development activities and in encouraging regional co-operation.

18. The contribution of the private sector to multilateral agencies has been inhibited lately by governmental reluctance to allow access to private capital markets to the agencies for bond issues. Relaxation of barriers to bond flotations as well as preferential access for multilateral financing institutions to private capital markets would make a valuable contribution to the expansion of the agencies' activities.

Chapter I

Growth and external resources

19. Over half of the Development Decade has passed and there has been virtually no improvement in the rate of economic growth of the developing countries as a whole. The rate of growth of production in 1960-1966 was about the same as that attained in the 1950s and below the 5 per cent rate established as a goal of the Development Decade (see table 1). The rate of growth of per capita income, about 2 per cent in 1960-1966, was lower than in the preceding decade owing to an acceleration in the rate of population increase. From the 1950s to the mid 1960s the growth rate of the developed market economy countries showed a marked increase. Growth in the socialist countries declined over the period but remained at relatively high levels. Thus although the developing countries' progress has not been insignificant it has not been sufficient to narrow the gap between their *per capita* incomes and those of the advanced countries.

20. External financial resources are not intended to play a dominant role in the process of development and the major contribution to a country's development must come from its own resources. At present, over 80 per cent of investment in developing countries is financed by domestic savings and exports are nearly always a more important source of foreign exchange than capital inflows. Nevertheless, external development finance can act as a vital catalytic agent both by adding to the potential investment and output of a developing country and by increasing its access to imported technology.

TABLE 1

Growth of real gross product of developing countries by region, and of developed countries, 1950-1966

	Annual compound growth rates (percentage)		
	1950-1955	*1955-1960*	*1960-1966*[a]
Developing countries[b]	4.7	4.6	4.5
Per capita	2.8	2.2	2.0
Asia	4.0	3.9	4.4
Per capita	2.4	1.4	1.9
Latin America	5.1	4.8	4.8
Per capita	2.3	2.1	1.9
Developed market economy countries	4.6	3.2	5.0
Per capita	3.6	2.0	3.6
Socialist countries of Eastern Europe[c]	9.7	8.1	6.8[d]
Per capita	8.1	6.7	5.5[d]

Sources: UNCTAD secretariat, based on: data supplied by the Statistical Office of the United Nations, and United Nations, *Statistical Yearbook*, various issues; OECD, *National Accounts of Less-developed Countries, 1950-1966* (Paris, 1968); United States Agency for International Development, (USAID) *Gross National Product* (RC-W-138, 31 March 1967) and national sources.

[a] Preliminary.

[b] Includes the following African and Middle Eastern countries: Algeria, Congo (Kinshasa), Ghana, Kenya, Malawi, Morocco, Nigeria, the former Federation of Rhodesia and Nyasaland, Sudan, Tanzania (Tanganyika only), Tunisia, Uganda, United Arab Republic, Upper Volta; and Iraq, Israel, Lebanon, Syria.

[c] Gross material product.

[d] 1960-1965.

21. In his *1966 Review*, the Chairman of DAC stated that in view of the low level and slow rate of improvement in the levels of economic productivity in developing countries :

> " ... there can be not doubt that here is still a need to expand the contributions made by external assistance. The new level reached in 1965 is still considerably below the existing estimates of the volume of capital and technical assistance which can be effectively used by the less-developed countries."[1]

Similar views were expressed by the Committee on Invisibles and Financing related to Trade when it agreed unanimously early in 1967 that:

> " ... most developing countries could immediately put into effective use a greater volume of external assistance. "[2]

22. Although successful growth performance is the product of many factors, it is instructive to note that most of the developing countries that achieved a fairly rapid growth of output from 1960 to 1965 are those in which the growth of foreign exchange receipts was particularly high. As pointed out on page 101 of the *1967 Annual Report* of the International Monetary Fund (IMF) :

> " In almost all of the countries where total real output was rising rapidly from 1960 to 1965—i. e., by 7 to over 10 per cent per annum—exports of goods and services were rising considerably faster, in some cases by as much as 15 to 20 per cent per annum or even more. "

The report also states that :

> " In a considerable number of countries the failure to achieve an adequate growth of foreign exchange earnings has imposed a brake on the rate of economic development and has in some cases entailed grave difficulties for the internal management of the economy or severe balance of payments difficulties. "

23. There is a certain asymmetry between the importance of development finance to developed countries on the one hand and to recipients on the other. In the former countries development assistance does not always form an integral part of government expenditure and is not treated on a par with other budget items. It is frequently regarded as a residual item and may be strongly influenced by considerations other than international goals of economic development.[3] By contrast in recipient countries foreign aid or increased trade receipts may be components of development programmes without which complementary domestic efforts would be greatly reduced in effectiveness. This does not, of course, mean that the volume of foreign exchange receipts is the sole factor determining the rate of growth of production. No less important is the manner in which developing countries utilize both domestic and foreign resources in the development process. However, other things being equal, the greater the availability of finance for imports, the greater is the potential for economic growth, especially for a small country with a limited domestic market.

Chapter II

Current flows of external financial resources

24. Total flows of financial resources (net of amortization and capital repatriation) to multilateral agencies and recipient countries of Africa, Asia and Latin America from developed market economy countries increased markedly in 1965 but suffered a setback in 1966.[4] Total net flows had dipped sharply in 1962-1963,

[1] See OECD, *Development Assistance Efforts and Policies, 1966 Review* (Paris, 1966), p. 11.

[2] See " Agreed statement on the problems of development " (*Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3* (TD/B/118/Rev. 1, annex II), section A, para. 1.

[3] See United Nations, " Factors affecting the ability of developed countries to provide resources to the developing countries : report of the Secretary-General " (*Official Records of the Economic and Social Council, Forty-third Session, Annexes*, agenda item 5, document E/4375).

[4] United Nations reports on financial flows normally refer to recipient countries of Africa, Asia and Latin America. References in the text relate to these areas where data permit. OECD and DAC data include flows to European recipient countries. To facilitate comparison table 2 of this study includes data on total flows to European recipient countries from twenty-two developed market economy countries. The figures in the text and tables pertaining to developed market economy countries include estimates of net private export credits based on annual net changes in government-guaranteed private export credits reported by OECD. As it is not at present possible to obtain a precise regional breakdown of unguaranteed private export credits they have not been included in the text and tables of this document. (See *Measurement of the flow of resources to developing countries : a report on methodological problems by a group of experts appointed by the Secretary-General*) (United Nations publication, Sales No. : 67.II.D.17) (E/4327), p. 19.

TABLE 2

The net flow of financial resources[a] from developed market economy countries,[b] 1960-1966

($U.S. million)

	1960	1961	1962	1963	1964	1965	1966[c]
I. *Recipient countries of Africa, Asia and Latin America*[d]							
Bilateral official	3,981	4,717	4,977	5,277	5,183	5,427	5,557
Bilateral private	2,519	2,343	1,627	1,821	2,031	2,881	2,133
Net private export credit[e]	382	498	563	467	659	537	803
II. *Multilateral agencies*[f]							
Official	595	840	628	407	473	574	428
Private	185	112	247	—31	141	248	22
Sub-total (I + II)	7,662	8,510	8,042	7,941	8,487	9,667	8,943
III. *European recipient countries*[g]							
Bilateral official	404	570	464	452	320	356	382
Bilateral private	60	127	71	111	152	179	181
Net private export credit[e]	116	110	32	122	164	175	187
Total (I + II + III)[h]	8,242	9,317	8,609	8,626	9,123	10,377	9,693

Sources: UNCTAD secretariat, based on: IMF, *International Financial Statistics, 1961-1967*, International Bank for Reconstruction and Development (IBRD) tables; OECD, *Development Assistance Efforts and Policies, 1967 Review* (Paris, 1967); *Geographical Distribution of Financial Flows to Less-Developed Countries — 1960-1964* (Paris, 1966); *Geographical Distribution of Financial Flows to Less-Developed Countries — 1965* (Paris, 1967); *The Flow of Financial Resources to Less-Developed Countries, 1961-1965* (Paris, 1967); special questionnaire issued jointly by the United Nations Secretariat and IMF.

[a] The 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 recipient countries or of investment income.

[b] 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.

[c] Preliminary.

[d] Countries and territories other than (i) those included in notes [b] and [g] of this table, (ii) the socialist countries of Eastern Europe and Asia, (iii) United States overseas possessions and territories except the Trust Territory of the Pacific Islands and the Ryukyu Islands.

[e] Net change in guaranteed private export credits reported by OECD. For 1966 these data include DAC members only.

[f] Including grants and other contributions, capital subscriptions, repayments of loans made earlier by agencies of the developed market economy countries, participations and purchases of bonds relating to IBRD, measured net of repayment to, and disbursements in, the developed market economy countries, IDA, the International Finance Corporation (IFC), the United Nations Development Programme (UNDP) (Expanded Programme of Technical Assistance and Special Fund), the United Nations Children's Fund (UNICEF), the United Nations Fund for the Congo (UNFC), the United Nations High Commissioner for Refugees (UNHCR), the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), United Nations Technical Assistance (UNTA), the World Food Programme (WFP), the European Development Fund (EDF) and the Inter-American Development Bank (IDB). Contributions to the regular budgets of the United Nations and specialized agencies are not included. It should be noted that activities of multilateral agencies include European recipient countries as well as those of Africa, Asia and Latin America.

[g] Comprising the following countries and territories: Cyprus, Gibraltar, Greece, Malta, Spain, Turkey and Yugoslavia.

[h] Except for the exclusion of unguaranteed private export credits, the inclusion of non-DAC developed market economy countries and the method of calculating net flows to multilateral agencies (see note), the method used to calculate the total corresponds to that utilized by the Chairman of DAC in his *1967 Review*.

but after recovering in 1964 to a level comparable in money terms to that of 1961, were on average about 14 per cent higher in 1965-1966 than the average for the period 1960-1964. However, if export credits are excluded, in only two years during 1960-1966 did total net flows exceed those of 1961. In 1965 total net flows excluding export credits were about $1 billion higher than in 1961, but in 1966 the figure was only about $100 million above the 1961 total.

25. The volume of net financial flows from developed market economy countries to Africa, Asia and Latin America and the multilateral agencies was about $9.7 billion in 1965 and about $9 billion in 1966 in money terms (see table 2). Nearly three-quarters of the increase in 1965 over 1964 and nearly all of the decline in 1966 were due to fluctuations in private capital outflows. Over the period 1960-1966 the total net outflow of financial resources from twenty-two developed market economy countries amounted to about $59 billion. The United States accounted for 51 per cent of this amount, France for 15 per cent, the United Kingdom for 9 per cent and the Federal Republic of Germany for 7 per cent.

26. Total net official and private flows to multilateral agencies accounted for about 18 per cent of the 1965 increase in outflows from developed market economy countries, but were about 14 per cent lower in 1965 than in 1961. In 1966 these flows fell by 45 per cent, influenced by a sharp fall in private flows. Official contributions to multilateral agencies in recent years have remained below the amounts transferred in 1960-1962; private portfolio investment in multilateral agencies, which has fluctuated sharply in the 1960s, was at its highest level in 1965, falling to a very low level in 1966.

27. Gross disbursements from the socialist countries of eastern Europe and Asia are estimated to have been about $300-$500 million per annum in money terms during the period 1960-1966.

28. Although the great bulk of financial and technical assistance flowing to recipient countries is supplied by developed countries and multilateral agencies, in recent years some recipient countries have also undertaken programmes of technical assistance and, in a smaller number of cases, financial assistance and the extension of export credits. Among the countries with development assistance

programmes are Brazil, China (Taiwan), Israel, Kuwait, Mexico, Spain, United Arab Republic, Venezuela and Yugoslavia. Within the framework of the Colombo Plan, Burma, Ceylon, India, Indonesia, Malaysia, Pakistan, Philippines and Thailand have provided technical assistance.

29. There are a number of factors at work which reduce the effective, or real, transfer of financial resources to developing countries. Amortization payments have been an important factor in the apparent slackening of net official bilateral development assistance. As a percentage of the official gross lending of DAC members amortization amounted to about 27 per cent over the period 1963-1966.[5] Furthermore, payments of interest (which do not figure in the calculation of the net flows shown in table 2) were about 17 per cent of total official gross lending by DAC members in 1963-1966. Investment income payments by developing countries related to flows of private capital are estimated to have been nearly $5 billion per year in the mid-1960s, attributable in large part to petroleum producers.[6] There are, moreover, substantial flows of financial resources from developing to developed countries associated with investment decisions or with intermittent political and economic events which give rise to movements of " flight capital ".[7]

30. Increases in the prices of goods and services supplied by developed countries have also served to reduce the value of total flows of financial resources to recipients and multilateral agencies. Furthermore, during the 1960's increased tying of aid by a number of countries has tended to raise the price of goods supplied under assistance programmes above competitive levels.

Official assistance to recipient countries and multilateral agencies

31. Official net flows to recipient countries and multilateral agencies are perhaps the most appropriate indicators of development assistance efforts since private flows respond primarily to business incentives. Net flows of official development finance from developed market economy countries have been less subject than private capital to large fluctuations. Continuing the expansion begun in the 1950s, the official net flow from developed market economy countries rose by about $1 billion in 1961 to nearly $5.6 billion. In 1962-1964 official net flows stabilized at about $5.6 billion and then increased to $6 billion in 1965, remaining at about that level in 1966.

32. One of the fastest growing components of net official financial flows has been technical assistance as economically advanced countries have increased their efforts to transfer technical knowledge and skills to developing countries. Disbursements for technical assistance by developed market economy countries rose by about 10 per cent per year in 1964 and 1965, exceeding $1 billion in the latter year. In 1966 a further rise of about 15 per cent brought total disbursements for technical assistance to $1.2 billion.[8]

33. Another important development has been the increasing number of consultative groups through which interested countries and agencies attempt to co-ordinate their programmes for specific recipients. In 1965 about 38 per cent of total bilateral and multilateral aid to Africa, Asia and Latin America was directed to the ten developing countries[9] from those regions participating in consortia and consultative groups, or 14 per cent if India and Pakistan are excluded. Turkey and Greece, for which consortia have been organized by OECD, received 54 per cent of bilateral and multilateral aid to European recipient countries in 1965.

34. The flow of resources from the socialist countries of eastern Europe and Asia to the developing countries takes the following main forms :

(a) Grants, primarily in the fields of culture, education and health ;

(b) Long-term credits on a government-to-government basis which are granted under bilateral economic co-operation agreements ;

(c) Inter-governmental commercial credit agreements ;

(d) Commercial credits granted by individual foreign trade organizations of the socialist countries in connexion with a particular contract ; and

(e) " Swing " credits under bilateral payments arrangements.

The major share of financial resources provided by socialist countries is channelled through the economic co-operation agreements.

35. In recent years the development assistance programmes of the socialist countries have been characterized by an increase in the number and the geographic dispersion of the recipients of new commitments. Another noteworthy facet of their programmes has been the provision, in some cases, for local cost financing.

36. The socialist countries' commitments fluctuated markedly during the 1960s. (See table 3.) In 1962 and 1963 new commitments by these countries fell to $350 million or less from the level of approximately $1 billion reached in 1961. In 1964 a high point of $1.2 billion was reached. In 1965 and 1966 new commitments remained at over $1.1 billion.

[5] The data on interest and amortization payments include southern European recipient countries. For a detailed discussion of net transfers from developed countries, see below " The terms of financial flows and problems of debt servicing " (document TD/7/Supp.3), to be found in this volume.

[6] See United Nations, " Outflow of capital from the developed countries : progress report of the Secretary-General " (*Official Records of the Economic and Social Council. Forty-third Session, Annexes*, agenda item 5, document E/4374).

[7] *Ibid.*

[8] OECD, *Development Assistance Efforts and Policies, 1965 Review, op. cit.*, chap. VII ; *1966 Review, op. cit.*, chap. VII ; *1967 Review, op. cit.*, chap. III. Estimates of the value of technical assistance include assistance to southern European recipient countries.

[9] Colombia (IBRD) ; Ecuador (IDB) ; India (IBRD) ; Malaysia (IBRD) ; Nigeria (IBRD) ; Pakistan (IBRD) ; Republic of Korea (IBRD) ; Sudan (IBRD) ; Thailand (IBRD) ; Tunisia (IBRD). Indications in parentheses refer to organizing institutions.

TABLE 3

Socialist countries of eastern Europe and Asia: new commitments of bilateral economic assistance to developing countries, 1960-1966[a]

($U.S. million)

	1960	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*[b]
Total new commitments	868	1,256	316	350	1,246	1,125	1,147
Country of origin							
Bulgaria	—	23	2	6	—	43[c]	30
China (Mainland)	45	165	11	88	305	77	6
Czechoslovakia	115	198	1	20	118	53	192
Eastern Germany	27	79	—	—	71	132	—
Hungary	34	134	—	23	10	52	52
Poland	65	119	88	8	54	22	—
Romania	—	116	—	—	70	100	—
USSR	582	422	214	205	618	646	867

Sources: UNCTAD, "Review of trade relations among countries having different economic and social systems: report of the UNCTAD secretariat" (*Official Records of the Trade and Development Board, Fifth Session, Annexes*, agenda item 9, documents TD/B/128/Add.1-3), part two, (document TD/B/128/Add.2), table 14; United Nations, *World Economic Survey 1965, Part I, The financing of economic development* (United Nations publication, Sales No.: 66.II.C.1), table IV-1 and "International flow of long-term capital and official donations, 1961-1966: report of the Secretary-General" (E/4371), table 3.

[a] Data refer only to credits and grants reported in announcements referring to specific countries; they may differ from the totals actually granted by the socialist countries.

[b] Preliminary.

[c] Total for 1964 and 1965.

37. Average annual gross disbursements from the socialist countries in the 1960s may have been about $300-$500 million. Credit flows from the Soviet Union to developing countries associated with exports of complete plants and installations amounted to $137 million in 1961, rising continuously to $296 million in 1964.[10] For the period 1954-1965 disbursements of credits by the Soviet Union associated with exports of complete plants and installations amounted to about 36 per cent of its new commitments.[11]

38. Precise information is not available regarding net disbursements of financial resources by the socialist countries of eastern Europe and Asia. OECD has estimated that net bilateral disbursements by these countries amounted to about $300 million in 1961, $400 million in 1962, $375 million in 1963 and 1964, and $325 million in 1965. Contributions to United Nations technical assistance and relief programmes amounted to $10 million per year.[12]

39. Total new commitments of all DAC countries together continuously exceeded gross disbursements from 1960 to 1966.[13] The gap between the two items narrowed greatly in 1965 as commitments fell sharply from their very high 1964 level and disbursements rose to a peak for the period 1960-1965. (See table 4.) Although in 1966 new commitments increased by about $1 billion while gross disbursements rose by less than $250 million, the outlook is clouded by the tendency of disbursements to exceed new commitments in three of the major suppliers of assistance. Over the period 1964-1966 gross disbursements by the Federal Republic of Germany, the United Kingdom and the United States often exceeded their new commitments. Unless new commitments increase considerably, an expected rise in official disbursements in 1967 may reduce the funds in the pipeline, increasing the likelihood of a slow-down or decline in future net official bilateral outflows to developing countries. Indeed, without an increase in the programmes of the major countries the rapid expansion of the aid programmes of some of the smaller countries will not be sufficient to ensure a continuous strong expansion of total official bilateral disbursements.

40. The aid commitments undertaken by particular developed countries are the result of many interrelated factors, including international political considerations, special relationships with specific recipient countries, parliamentary and public attitudes toward assistance programmes, and the condition of the domestic economy and the balance of payments. The present outlook for an increase in total commitments is particularly affected by concern over balance of payments positions and budgetary factors.

41. There is a general tendency to overstate the balance of payments burden associated with aid programmes, and to exaggerate the scope for foreign exchange savings associated with cuts in foreign aid. Even

[10] See *World Economic Survey, 1965, Part. I, op. cit.*, p. 98 and table IV-2.

[11] See "Review of trade relations among countries having different economic and social systems : report of the UNCTAD secretariat" *op. cit.*, part two, (document TD/B/128/Add.2), para. 90.

[12] See OECD, *The Flow of Financial Resources to Less-developed Countries, 1961-1965, op. cit.*, p. 58.

[13] See OECD, *1966 Review, op. cit.*, Statistical Annex, part I, table 8 ; *1967 Review, op. cit.*, chap. III. These data on disbursements and commitments include southern European recipient countries.

TABLE 4

Total official bilateral commitments and gross disbursements of DAC countries, 1960-1965[a]

($ U.S. million)

	1960	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*
Australia							
Commitments	66[b]	73[b]	74[b]	78[b]	93[b]	130[c]	136[c]
Gross disbursements	66	73	74	78	93	109	115
Austria							
Commitments	...	1[b]	6	1	18	39	81
Gross disbursements	—	1	6	8	17	39	50
Belgium							
Commitments	86[b]	71[b]	66[b]	76[b]	79[b]	104[b]	82[b]
Gross disbursements	86	71	66	76	80	105	78
Canada							
Commitments	58	96	61	125	153	215	218
Gross disbursements	48	50	47	92	115	108	206
Denmark							
Commitments	—	2	1	7	6	9	17
Gross disbursements	1	3	1	1	3	5	11
Federal Republic of Germany							
Commitments	309	472	473	686	468	582	479
Gross disbursements	282	401	399	471	518	597	559
France							
Commitments	...	...	...	852	1144	1034	969
Gross disbursements	837	918	900	852	859	787	771
Italy							
Commitments	64[d]	205	131	154	155	282	455
Gross disbursements	107	128	140	185	155	171	157
Japan							
Commitments	75[b]	102[b]	117[b]	215	166	269	313
Gross disbursements	75	102	88	141	126	251	260
Netherlands							
Commitments	32	40	22	30	46	80	73
Gross disbursements	32	38	48	19	34	49	51
Norway							
Commitments	1	1	4	3	2	5	6
Gross disbursements	1	1	1	2	3	4	5
Portugal							
Commitments	40	65	42	54	43	33	43
Gross disbursements	37	39	42	51	68	31	33
Sweden							
Commitments	...	2	3	8	10	11	50
Gross disbursements	1	2	3	7	14	18	24
United Kingdom							
Commitments	392	475	578	475	751	437	450
Gross disbursements	345	442[d]	408[d]	413	500	496	530
United States							
Commitments	3,943	4,116	4,789	3,877	5,383	3,533	4,462
Gross disbursements	2,810	3,501	3,624	3,810	3,602	3,758	3,899
TOTAL							
Commitments	5,905	6,639	7,267	6,643	8,520	6,762	7,833
Gross disbursements	4,728	5,767	5,846	6,207	6,185	6,527	6,748

Sources: OECD, *1966 Review op. cit.*, statistical annex, part I, table 8; and *1967 Review, op. cit.*, table III.2.

[a] Including European recipient countries.

[b] Partly on a gross disbursement basis.

[c] Including disbursements to Papua and New Guinea.

[d] Incomplete figure.

if aid were untied, the balance of payments saving resulting from a cut in aid would not equal the full amount of the cut but only that proportion which would not be re-spent in the countries supplying assistance. Since tying is widespread, and since, in particular, the deficit countries are tying most of their aid, the balance of payments argument for reduced aid programmes has lost its validity.

42. Assistance programmes also face severe competition from other programmes for budgetary appropriations. At present net disbursements of development assistance are a small and in many cases a declining proportion of government expenditure in developed countries. This unfavourable situation is partly the outcome of high levels of defence and space expenditures in industrial countries and of the fact that many of these countries have become increasingly conscious of their own residual sectors of poverty, with the result that it is easier to get the necessary political support for domestic programmes than for external assistance.

43. One way of meeting some of the difficulties which aid programmes often face in passing through legislatures would be to operate the aid programmes on a revolving fund basis, so that repayment of interest and amortization on past debts would automatically become available for fresh assistance to developing countries. Even apart from this, the revolving fund idea has much to commend it, for the present practice in many countries of considering budgetary expenditures on a gross basis, i.e., without taking account of return flows from earlier aid operations, can easily exaggerate the real size of development assistance and distort its fiscal incidence.

44. The scale of international development needs has led to general agreement that a substantial transfer of resources to the developing countries will be required for many years to come. Because of its limited volume and inherent volatility, private investment alone cannot be relied upon to bring about this result and it is therefore necessary to lay particular emphasis upon the role of official development assistance policies. Ideally, it would be most desirable that countries should establish adequate aid programmes and maintain them regardless of changing economic conditions. It is doubtful whether cuts in aid commitments are an appropriate or effective means of dealing with temporary difficulties. However, if steps to insulate aid programmes from fluctuations in the economic situation are not feasible, it would at least be desirable to ensure that aid does not bear a disproportionate share of adjustments to domestic or international pressures.

45. Over the period 1956-1961, in only one year, 1959, did combined total net official flows from developed market economy countries decline as a percentage of their combined GNP. A peak of 0.57 per cent was reached in 1961. However, from 1962 onwards there was not a single year in which net official flows increased in relation to the combined GNP. By 1966 the ratio of net official flows to GNP had declined to 0.42 per cent, a figure equal to that recorded in 1957 and only slightly higher than the 0.37 per cent of 1956. This decline in the 1960s reflected the relatively rapid growth of gross output in most developed countries as well as the lagging net official disbursements of the major supplies of external resources.

46. In order to reverse the present tendency for official aid to decline relatively to GNP, a feasible aim for official development assistance programmes would appear to be that, as a minimum, the rate of increase of official flows (net of amortization) to recipients and agencies from each economically advanced country should not fall below the rate of growth of its GNP. This, however, would not be sufficient to ensure progress towards harmonization of the various development assistance programmes. To achieve such harmonization it might be further recommended that the net official flow to developing countries and multilateral agencies should increase more rapidly than GNP in those cases in which the ratio of net official flows to GNP was less than three-quarters of 1 per cent. Progress towards harmonization of net official flows could be encouraged by the establishment of a time-limit for the fulfilment of the target, say 1971. The present situation in this respect is set forth in table 5.

TABLE 5

Sixteen developed market economy countries: net official flows [a] as a percentage of GNP and total budget expenditure, 1965

Country	*GNP* [b]	*Total budget expenditure* [c]
Australia	0.52	2.87
Austria	0.40	1.44
Belgium	0.70	2.79
Canada	0.26	1.59
Denmark	0.08	0.47
Federal Republic of Germany	0.38	3.74
France	0.81	1.69
Italy	0.14	0.65
Japan	0.28	2.17
Netherlands	0.36	1.53
Norway	0.14	0.64
Portugal	0.49	...
Sweden	0.19	0.75
Switzerland	0.02	0.26
United Kingdom	0.45	1.43
United States	0.50	2.84

Source: UNCTAD secretariat, based on net official flows, see table 2; GNP: United Nations, *Yearbook of National Accounts Statistics, 1965* (United Nations publication, Sales No.: 66.XVII.2); net official flows as a percentage of total budget expenditure: " Factors affecting the ability of developed countries to provide resources to the developing countries: report of the Secretary-General ", *op.cit.*, table 8.

[a] Net official flows to recipient countries of Africa, Asia and Latin America and multilateral agencies.

[b] At market prices.

[c] The budget expenditure figures used in the calculation of ratios refer to those of the central government plus the net results of the current operations of government trading enterprises; they include transactions in goods and services, transfers and transactions in financial assets, but exclude transactions in financial liabilities. The budget figures for Australia, Sweden and the United States refer to fiscal years ending 30 June, and for Denmark and Japan to fiscal years ending 31 March. Data for total budget expenditures expressed in national currencies have been converted into United States dollars at the average annual exchange rate.

47. It would also be desirable to halt the present tendency for official aid programmes to decline as a proportion of total government expenditure. To this end it may well be useful to consider the establishment of a target for net official flows in relation to government

expenditure. Without prejudice to the 1 per cent development assistance target or to the goal for official net flows suggested above, as a minimum first step it might be agreed that the net flow of official resources to agencies and recipient countries from each country should increase at least as fast as total government expenditure.

48. Evaluation of development assistance efforts based solely on the ratio of financial flows to GNP or government expenditure does not reflect the relative per capita incomes of various suppliers of financial resources, nor does it bear any specific relationship to the requirements of the recipient countries. There have therefore been suggestions for the introduction of an element of progressivity into national aid contributions. For example, the study of an international fiscal system has been mentioned as a possible first step toward the establishment of a basis for the international redistribution of income. Although there is little chance of the early adoption of ideas along these lines, such a system has much to commend it and is in the long run no more impracticable than progressive taxation at the national level.

Multilateral assistance to recipient countries

49. The difficulties encountered by developing countries in obtaining substantially increased bilateral flows and in securing firm commitments for periods long enough to allow co-ordination of external finance with development plans have given rise to suggestions for an increase in the share of multilateral agencies in providing financial assistance. It was agreed unanimously at the first session of the Conference, by recommendation A.IV.4 (para. I (*d*)), that there should be encouragement for the "channelling of external resources, whenever possible and appropriate, through multilateral institutions—including regional development institutions".[14]

[14] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 42.

50. Although bilateral flows have been, and most probably will continue to be, the most important component of development assistance, there is a strong case for greater use of multilateral channels based on considerations of objectivity and efficiency. Multilateral agencies may be better able than national agencies to adopt and implement objective criteria for the granting of aid and they may also be able to administer aid programmes more efficiently and with greater economy. Complications are apt to arise where countries receive aid from a multiplicity of sources, each employing a different language, applying different standards and offering different terms and conditions. Moreover, experience seems to show that multilateral agencies may be more successful than national agencies in securing fulfilment of obligations assumed by recipient countries with respect to their development programmes. Co-ordination of aid through consortia and consultative groups represents an effort to reconcile the desire of developed market economy countries to retain control over the bulk of their aid expenditures with the need to harmonize a variety of bilateral programmes.

51. In addition to providing grants and loans for investment purposes the multilateral agencies have complemented the activities of individual countries in the field of technical co-operation with significant contributions in pre-investment activities, agricultural training, assistance in the formulation of monetary, fiscal and exchange policies, and the preparation of development projects and programmes.

52. The total net disbursements of multilateral institutions in recipient countries of Africa, Asia and Latin America grew steadily during the period 1960-1966. (See table 6.) However, in 1963-1965 net disbursements by IBRD declined from the level reached in 1962 as repayments fell due on previous loans. In 1966 net disbursements from IBRD reached a peak for the period 1960-1966. The decline in net disbursements of IDB in 1965 was due to payment of subscriptions by recipient countries: disbursements less repayments on previous loans

TABLE 6

Net flow of resources from multilateral agencies[a] to recipient countries of Africa, Asia and Latin America, 1960-1966

($U.S. millions)

Agency	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*
EDF	3	16	55	67	84	104	112
IBRD	259	197	271	249	231	256	300
IDA	—23	—37	—26	42	95	259	256
IDB[b]	—69	—107	33	140	168	70[c]	185
IFC	13	9	12	7	10	9	20
United Nations agencies	105	148	157	198	206	198	200[d]
Total	288	226	502	703	794	896	1,073

Sources: UNCTAD secretariat, based on OECD, *Geographical Distribution of Financial Flows to Less-Developed Countries, 1960-1964* and *1965 op. cit.*; and reports of multilateral agencies.

[a] Grants and loans less subscriptions and contributions (regardless of whether they have been made in the currency of the recipient country or in other currencies) and participations and repayments where relevant.

[b] Of which Social Progress Trust Fund:

1960	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*
—	2	23	66	65	68	66

[c] Total subscriptions of currencies and non-negotiable obligations by recipient countries to IDB were $101 million in 1965. Disbursement net of repayments from IDB in 1965 were $171 million (including Social Progress Trust Fund).

[d] Estimate.

were at almost the same level in 1965 as in 1964. At the end of 1966, IDB had uncommitted resources of only $567 million. For multilateral agencies as a whole disbursements in 1963-1966 were well in excess of receipts. This resulted in a steady depletion of the resources of some of these agencies, in particular IDA, whose replenishment is now under discussion. At the close of the fiscal year 1966/67 IDA's undisbursed resources amounted to $87 million, but these funds were either formally committed or earmarked for projects under appraisal or negotiation.

53. Access by multilateral agencies to the private capital markets of developed market economy countries has been restricted in recent years. IBRD, whose strong credit standing is unquestioned, is currently faced with the prospects of inadequate resources. According to IBRD's own estimate, it would need at least $400-$500 million annually over the next few years to meet its undisbursed commitments and its maturing debt.[15] However, because of the growing reluctance of governments to allow the issue of its bonds on their national capital markets, IBRD does not feel confident of its ability to raise all needed funds through the sale of bonds. The Governors of IBRD therefore decided in 1967 to cut drastically to $10 million the transfer to IDA out of net income of IBRD, and to allocate the entire remaining income to IBRD's Supplemental Reserves, thereby reducing its need for new bond issues. Previous transfers to IDA were $50 million in 1964 and $75 million in both 1965 and 1966. Thus the squeeze on IDA resulting from delay in replenishing its resources by direct government subscription was compounded by the sharp reduction in the Bank's transfer out of its net income.

54. In the past, financing the establishment, or expanded activity, of multilateral agencies has called forth increased development assistance efforts by economically advanced countries. Support of regional development banks should also lead to an increased outflow to multilateral institutions. Regional institutions have a great potential for eliciting joint efforts from developing countries. Their potential promotion of regional integration and co-operative projects is an example of a particularly effective use of external development finance. To maintain the expanded scale of its activities IDB has recently requested that its capital resources be increased by $2.2 billion, $1 billion for IDB's callable capital and $1.2 billion for the Fund for Special Operations. These proposed increments would take place in 1968 and 1970 in the case of the callable capital and, beginning at the end of 1967, in three equal instalments for the Fund for Special Operations. The Asian Development Bank has now received pledges for its initial subcription of $1 billion and the African Development Bank has commenced its operations with capital resources set at $250 million. Although it would be premature to call for an immediate increase in the ordinary capital of the African and Asian Development Banks, their need for funds for concessional loans is in the longer run no less urgent than that of IDA and IDB.

Private capital flows

55. Private long-term investment, direct and portfolio, which on average has accounted for under one-third of the total capital flow from developed market economy countries in the years 1960-1966, increased sharply in 1965 but fell by about 26 per cent in 1966. The rise in 1965 took place despite restraints on the outflow of private capital imposed by the United Kingdom and the United States in 1965 owing to balance of payments difficulties, but these restraints may have contributed to the decline in private flows in 1966.[16]

56. While subject to fluctuations private export credits have expanded considerably over the period 1960-1966 in response not only to the export promotion goals of developed countries but also to a need to satisfy strong demands for capital in recipient countries, even on terms and conditions which may be harmful to development.[17]

57. The relative share of recipient countries of Africa, Asia and Latin America in total flows of direct private investment reported to IMF in 1961-1965 was below their relative share in 1958-1960. Furthermore, the average absolute level of recorded direct investments in these countries in 1961-1965 was below those of the earlier period. In 1963-1965 recorded direct investment increased, but not sufficiently to allow an increase in the share of developing countries in the total relative to the late 1950s.[18]

58. Outflows from the private sector of the developed market economies in the 1960s have been characterized by wide fluctuations. In view of the volatile nature of private capital flows it would be difficult to forecast the volume of these flows in the future. Current national and international efforts to provide incentives and safeguards to private investors may, however, in addition to stimulating the outflow of private capital, add an element of stability to this flow. The incentive programme of the United States is the largest in scope—nearly $860 million in investment guarantees were provided in the fiscal

[15] See statement by the representative of the International Bank for Reconstruction and Development at the 13th meeting of the Sessional Committee on IBRD transfers to the International Development Association (Trade and Development Board document TD/B/SC.7/L.4).

[16] The United Kingdom programme of restraints did not until May 1966 distinguish between developed and developing countries. The United States interest equalization tax exempts developing countries. The present guidelines to United States financial institutions specify that 90 per cent of the outflow of funds permitted under the voluntary ceiling should be directed to loans to developing countries or to export credits. Guidelines to United States non-financial corporations specify that "non-export credits and investments in less-developed countries should be given priority second only to that for export financing". See *Federal Reserve Bulletin*, December 1966, pp. 1753-1760.

[17] See below "The terms of financial flows and problems of debt servicing" document TD/7/Supp.3), to be found in this volume.

[18] See Marcus Diamond, "Trends in the flow of international private capital 1957-65" (*IMF Staff Papers,* March 1967), table 5.

year 1964/65 and $1.1 billion in 1965/66.[19] Among the other countries which provide insurance schemes or other incentives to investors in developing countries are Australia, Austria, Denmark, Federal Republic of Germany, Japan and the Netherlands. Detailed studies of the promotion of private investment in developing countries are found elsewhere.[20]

59. In addition to the above bilateral measures applying to direct investment the private capital markets of some developed countries have become accessible to a limited number of developing countries.[21] At present only one country, the United States, has allowed, through the operation of the interest equalization tax, preferential treatment of developing countries utilizing its capital market. Although tax exemptions and government guarantees can facilitate use of private capital markets by developing countries, systems of interest subsidies would offer the most certain way of reducing the cost to developing countries of borrowing on capital markets.

60. As regards international measures to encourage private investment in developing areas, a report has been submitted by OECD to IBRD on the possible creation of a multilateral investment insurance scheme. This matter is at present under consideration by the Executive Director of IBRD.[22] The OECD is also engaged in formulating a convention for the protection of private property with the intent of fostering a greater flow of private capital to developing countries. The Convention on Settlement of Investment Disputes between States and Nationals of other States, approved by the Executive Directors of IBRD in March 1965, has now come into force. Furthermore, the private sector has itself initiated international programmes to promote the flow of private investments. The Atlantic Community Development Group for Latin America (ADELA), for example, is engaged in a programme involving equity investments in Latin America, as well as loans to firms in countries of the region.

[19] It should be noted that the figures for total guarantees may involve double counting to the extent that the investment may require more than one guarantee depending on the risks to be covered. Taking into account the further fact that some guaranteed investments would have occurred in the absence of the guarantee programme, it has been estimated that the total additional investment attributable to the United States programme was less than $150 million in 1965. See Chase Manhattan Bank, *World Business* (July 1966), pp. 4-7.

[20] United Nations, *Foreign investment in developing countries* (United Nations publication, Sales No.: E.68.II.D.2) and United Nations Industrial Development Organization, "Tax incentives for industrial development" (ID/CONF.1/22).

[21] United Nations, "Factors affecting the ability of developed countries to provide resources to the developing countries: report of the Secretary-General", *op. cit.*

[22] See "Report by the International Bank for Reconstruction and Development on the status of its studies on multilateral investment guarantees: note by the Secretary-General of UNCTAD" (*Official Records of the Trade and Development Board, Third Session, Annexes*, agenda item 4, document TD/B/55), and "Second report on the status of studies by the International Bank for Reconstruction and Development on multilateral investment guarantees: note by the Secretary-General of UNCTAD" (*Ibid., Fourth Session, Annexes*, agenda item 3, document TD/B/98).

The distribution of external development finance

61. During 1960-1965 net flows of multilateral finance and official bilateral finance from developed market economy countries increased to each of the three major developing regions. After a sharp increase in 1961 the share of Latin America remained relatively stable at about 17 per cent. Asia's share, after a decline in 1961-1962, recovered to over 50 per cent in 1965. The share of Africa as a whole experienced a relative decline, from about 35 per cent in 1960 to about 27 per cent in 1965. This decline was due to a decline in the share of north Africa; the share of Africa south of the Sahara increased from about 16 per cent of total net flows in 1960 to about 19 per cent in 1965.[23] As regards private capital in the 1960s, although the available data do not permit exact allocation of all flows, it would appear that of the three regions, Latin America received the largest proportion, with Africa and Asia following in that order.

62. Outflows from individual developed market economy countries tend to be concentrated upon a relatively small number of recipient countries and, by the same token, recipient countries may derive a large proportion of their external finance from only one or two sources. For example, over 60 per cent of USAID economic assistance in the fiscal year 1965/66 was channelled to three countries.[24] In 1964/65, over 90 per cent of French net official aid was directed to the franc area. Over 70 per cent of net bilateral flows from the United Kingdom in 1964/65 was directed to the Commonwealth, with four countries receiving over 60 per cent of net flows to Commonwealth members.[25] Patterns of concentration are common among other developed countries but their share of the total net flows to regions and individual countries is usually smaller than those cited for the larger developed market economy countries.

63. Concentration of inflows is more marked in some individual countries. Brazil, India and Pakistan, for example, received in 1964-1965 over 60 per cent of their total net bilateral and multilateral finance from the United States. In Africa, France and the United Kingdom are major sources of external finance for individual countries. France accounted for over 80 per cent of Algeria's bilateral and multilateral receipts in 1964-1965 and the United Kingdom accounted for over 80 per cent of Kenya's in the same period.

64. The per capita flow of net official and multilateral resources is one measure of the intensity of the potential contribution of these external flows to the development of a recipient country. There were substantial disparities in average per capita aid inflows from developed market economy countries and multilateral agencies to various developing sub-regions in 1960-1965. The average ranged from $2.34 (South Asia) to $12.21 (North Africa). However, there has been a considerable narrowing of the range of annual averages of seven sub-regions. The

[23] Oceania and unallocated flows accounted for about 5 per cent of the total during the period.

[24] Brazil, India, Republic of Viet-Nam.

[25] India, Kenya, Nigeria, Pakistan.

decline of average annual per capita aid to North Africa from the very high levels of over $14.00 in 1960-1961 to about $8.00 in 1965 was particularly marked. Among the other regions, in 1960 the highest average $5.54 (Middle East), was 6.5 times as large as the lowest, $0.85 (South America). In 1965 the highest average $5.22 (Middle East), was less than twice as large as the smallest, $2.95 (South Asia). Preliminary data for 1966 indicate that the tendency toward more comparable per capita flows continued.

65. In four sub-regions with the lowest averages in 1960—South America, South Asia, North and Central America, and Africa south of the Sahara—per capita aid increased over the period 1960-1965. In all four areas multilateral agencies made a major contribution to the increase in per capita aid. In two sub-regions, the Middle East and the Far East, expansion of multilateral programmes offset a decline in net bilateral disbursements. An expansion of the activities of multilateral agencies, and in particular of the regional institutions, could therefore make a further significant contribution to a more balanced regional distribution of per capita aid.

66. There is considerable variation among recipient countries with respect to the net inflow of capital per capita. The dispersion of countries shown in table 7 suggests that income per head is not an important influence on the distribution of external development finance. The data indicate, however, that small countries generally tend to receive above average inflows per head and that many low-income countries tend to receive below average inflows per head. It should be borne in mind that it is often the low-income countries that have greatest difficulty in expanding or diversifying their exports, and that these countries are also frequently unable to provide strong attractions to foreign private capital. Thus their requirements for external assistance are particularly pressing: there is need for a development strategy that would take this consideration into account.

Chapter III

The development assistance target

67. In 1960 the General Assembly of the United Nations, in its resolution 1522 (XV) recommended "that the flow of international assistance and capital should be increased substantially so as to reach as soon as

TABLE 7

Forty countries: net capital inflows, per capita and gross domestic product (GDP)[a] per capita 1963-1965

Average net capital inflow per capita ($US)	*Average GDP per capita[b] ($US)* Over 700	600-699	500-599	400-499	300-399	200-299	100-199	Under 100
Over 100	—	—	—	Surinam	—	—	—	—
50-99	Israel	—	—	—	—	—	—	—
40-49	—	—	—	—	—	Jordan	—	—
30-39	—	—	—	Costa Rica	—	—	—	—
20-29	—	—	—	Panama	—	Libya	Tunisia	—
15-19	—	—	—	—	Chile Malaysia	—	—	—
10-14	—	Uruguay	—	—	Dominican Republic Nicaragua	Ghana	Bolivia Republic of Viet-Nam	—
5-9	—	—	—	Mexico	Guatemala	Colombia El Salvador Honduras Paraguay China (Taiwan)	Morocco Pakistan United Arab Republic	—
0-4	Argentina	—	—	—	—	Brazil Ecuador Iraq Syria	Sudan Ceylon Philippines Thailand	Ethiopia Nigeria Burma India
Less than 0	Venezuela	—	—	—	—	Iran	—	—

Sources: UNCTAD secretariat, based on: IMF, *Balance of Payments Yearbook* and United Nations, *Yearbook of National Accounts Statistics, 1965 op. cit.*, and *Monthly Bulletin of Statistics*, January 1967.

[a] At market prices.

[b] Per capita GDP data for 1964 were used as the basis for classifying countries.

possible approximately 1 per cent of the combined national incomes of the economically advanced countries". In 1961, the 1 per cent target was reaffirmed by the General Assembly in its resolution 1711 (XVI) in connexion with the initiation of the Development Decade, and in 1964 the United Nations Conference on Trade and Development at its first session recommended that each economically advanced country should, at a minimum, endeavour to reach the 1 per cent target which was defined in terms of certain net capital flows.[26] In 1965, the DAC urged its member governments to "attain and if possible exceed" the UNCTAD target.[27]

68. In reaffirming the target in connexion with the Development Decade in 1961, the General Assembly had before it a report which presented a comparison of outflows of financial resources to developing countries and multilateral agencies to the combined gross domestic products of the developed countries.[28] Opening the debate on this matter in the Second Committee of the General Assembly at its sixteenth session, the Under-Secretary for Economic and Social Affairs stated that the current annual value of capital transfers from the industrial countries to the rest of the world represented 0.8 per cent of their aggregate gross national income.[29] On the basis of this information the General Assembly noted in its resolution 1711 (XVI) "that the flow of capital towards the less developed countries in the years 1951-1959 was less than 1 per cent of the combined national incomes of the economically advanced countries" and called again for a substantial increase in the flow of capital so as to reach the 1 per cent target. It would therefore appear that the General Assembly intended the term "national income" to be understood in a gross rather than a net sense, particularly since it followed from the report which the Assembly had before it that the achievement of the 1 per cent target defined in terms of net national income at factor cost would not have required a substantial increase in capital flows: indeed, in terms of net national income the target had already been achieved. Subsequent United Nations and UNCTAD documents have followed the intent of the General Assembly and have continued to discuss the 1 per cent target in terms of the gross income or product concept.[30]

69. Outside the United Nations gross national accounting concepts have been widely used in the calculation of the target ratio both by governments and by professional economists.[31] In considering the differences in assistance efforts among DAC countries the Chairman of DAC in 1961 reported that the flow of official resources to recipient countries and multilateral agencies was on average 0.8 per cent of GNP at factor cost for all DAC countries.[32] In 1963 and 1964 the analysis of capital flows in the DAC Chairman's *Review* also referred to the gross national products of DAC members. In his *1963 Review*, the DAC Chairman stated: "The most important factor in any effort to compare levels of assistance is, of course, the economic and financial potential of a country, which is broadly measured by the size of its gross national product."[33] In the *Reviews* of 1965 and 1966, however, data on the target were presented on the basis of net national product at factor cost. In the *1967 Review* it is reported that the matter is expected to be considered by the DAC in connexion with the second session of the United Nations Conference on Trade and Development.

70. Professional opinion appears to favour the interpretation of national income in a gross sense in connexion with the assistance target. In its final report the United Nations group of experts on the measurement of the flow of resources to the developing countries has advocated use of gross national product at market prices as the most suitable denominator for the target ratio.[34]

71. Following the recommendations of the United Nations expert group, table 8 presents the ratios of net flows of financial resources, including net changes in guaranteed private export credits, to the GNP at market prices of developed market economy countries in the

[26] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), pp. 43-44. The definition, given in a footnote to the recommendation, is as follows: "Official cash grants and grants in kind (including grants for technical assistance); sales of commodities against local currencies; government lending for periods exceeding one year (net of repayment of principal); grants and capital subscriptions to multilateral aid agencies, and net purchases of bonds, loans and participation from those agencies; private capital on the basis of net long-term movements, originating with residents of the capital-exporting countries; they are thus net of repatriation of principal, disinvestment and retirement of long-term loans, portfolio assets and commercial debt. They are not net of reverse flows of capital originating with residents of the less developed countries, nor of investment income."

[27] See OECD, *1965 Review, op. cit.*, annex A, p. 115.

[28] United Nations, *International flow of long-term capital and official donations, 1951-1959* (United Nations publication, Sales No.: 62.II.D.1).

[29] See *Official Records of the General Assembly, Sixteenth Session, Second Committee*, 717th meeting.

[30] See the following United Nations reports: *International Flow of Long-term Capital and Official Donations, 1951-1959, op. cit.*, p. 11; *International Flow of Long-term Capital and Official Donations, 1959-1961* (United Nations publication, Sales No.: 63.II.D.2), p. 15; *International Flow of Long-term Capital and Official Donations, 1960-1962* (United Nations publication, Sales No.: 65.II.D.1), pp. 14-15; *International Flow of Long-term Capital and Official Donations, 1961-1965* (United Nations publication, Sales No.: 66.II.D.3); pp. 15-17; "The international flow of long-term capital and official donations, 1961-1966" (E/4371 and Corr. 1) (mimeographed), pp. 19-23; *The Capital Development Needs of the Less Developed Countries* (United Nations publication, Sales No.: 62.II.D.3); see also *Official Records of the Trade and Development Board, Fourth Session, Annexes*, agenda item 3, document TD/B/82/Add. 1, and Trade and Development Board document TD/B/C.3/4/Add. 1 (mimeographed).

[31] See USAID, *Proposed Mutual Defense and Assistance Programs, Fiscal Year 1964* (Washington, D.C.), p. 104, and "Statement by Mr. Sidney Dell, Director of the New York Office of UNCTAD at the sixth meeting of the Committee" [on Invisibles and Financing Related to Trade] (Trade and Development Board document TD/B/C.3/L.18), p. 2.

[32] See OECD, *Development Assistance Efforts and Policies in 1961* (Paris, 1962), p. 16.

[33] OECD, *Development Assistance Efforts and Policies, 1963 Review* (Paris, 1963), p. 22; see also the *1964 Review* (Paris, 1964), pp. 24-25.

[34] See *Measurement of the Flow of Resources to Developing Countries, op. cit.*, pp. xiv and 21-24.

TABLE 8

The development assistance target ratio[a] 1960-1966

Country	Percentage of GNP *1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*[b]
Australia	0.54	0.54	0.41	0.49	0.55	0.63	0.69
Austria	0.02	0.06	0.17	—	0.20	0.52	0.31
Belgium	1.52	1.41	0.99	1.28	1.03	1.13	0.97
Canada	0.39	0.27	0.29	0.28	0.32	0.36	0.50
Denmark	0.59	0.35	0.16	−0.02	0.19	0.21	0.25
Federal Republic of Germany	0.68	0.92	0.70	0.58	0.55	0.55	0.51
Finland	−0.26	−0.19	−0.18	−0.06	−0.07	−0.17	...
France	2.20	2.07	1.89	1.52	1.48	1.33	1.19
Iceland	0.62	0.59	−0.74	−0.50	−0.14	0.44	...
Ireland	0.07	0.07	0.06	0.05	0.08	0.05	...
Italy	0.81	0.49	0.77	0.58	0.36	0.40	0.73
Japan	0.64	0.58	0.37	0.35	0.36	0.50	0.44
Luxembourg	0.66	0.65	−0.04	0.02	0.03	0.10	...
Netherlands	2.27	1.77	1.08	0.88	0.66	1.12	0.99
New Zealand	0.11	1.05	0.17	0.13	−0.20	0.06	...
Norway	0.22	0.14	0.07	0.27	0.21	0.38	0.16
Portugal	1.49	1.63	1.42	1.65	1.58	0.74	0.74
South Africa	0.78	0.39	0.23	0.07	−0.11	0.29	...
Sweden	0.33	0.34	0.22	0.29	0.42	0.33	0.42
Switzerland	1.82	2.06	1.42	1.28	0.85	0.87	...
United Kingdom	1.07	1.09	0.88	0.73	0.91	0.65	0.87
United States	0.70	0.78	0.72	0.71	0.71	0.76	0.57
Average	*0.83*	*0.87*	*0.76*	*0.70*	*0.69*	*0.72*	*0.62*[c]

Sources: UNCTAD secretariat based on: Financial resources: see table 1; GNP: United Nations, *Monthly Bulletin of Statistics* and *Yearbook of National Accounts Statistics*, various issues.

[a] Net flows of financial resources, including net changes in guaranteed export credits, from individual developed market economy countries to the recipient countries of Africa, Asia and Latin America and the multilateral agencies, as a percentage of gross national product at current market prices. The table conforms to the recommendations concerning GNP and guaranteed private export credits made by the Expert Group on the Measurement of the Flow of Resources to Developing Countries (see *Measurement of the flow of resources to developing countries: a report on methodological problems by a group of experts appointed by the Secretary-General, op. cit.*, pp. xiv, 19 and 24).

[b] Preliminary.

[c] Including estimates for Finland, Iceland, Luxembourg, New Zealand, Portugal' South Africa and Switzerland.

period 1960-1966.[35] It can be seen that in general the flows of development finance have failed to match increases in output in these countries during the Development Decade. Although, as noted earlier, the net flow of capital from these countries was 14 per cent higher in money terms in 1965-1966 than in 1960-1964, the ratio of this flow to the combined GNP declined considerably during the same period—from 0.77 per cent in 1960-1964 to 0.72 per cent in 1965 and 0.62 per cent in 1966. This trend is apparent in the majority of the twenty-two countries listed in the table which are further from reaching the goal of the 1 per cent target than they were at the beginning of the Development Decade. In many cases, moreover, the ratio has declined from levels reached in the later 1950s.[36]

[35] Net flows to multilateral agencies and recipients in Africa, Asia and Latin America were divided by GNP. Average ratios for all donor countries corresponding to the total in table 2, i.e. including southern European recipients, were as follows:

1960	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*
0.88	0.95	0.82	0.76	0.75	0.78	0.69

[36] See United Nations, "Factors affecting the ability of developed countries to provide resources to the developing countries: report of the Secretary-General" *op. cit.*, fig. 1.

72. It has been estimated that the average annual addition to aid commitments by the socialist countries of Eastern Europe and Asia is well under 1 per cent of their gross ouput.[37] It is therefore likely that the ratio of the disbursements of each of these countries to its gross output is also considerably less than 1 per cent.

73. Table 8 also show that in 1966 only one country — France — met and exceeded the target. Belgium and the Netherlands exceeded the target in 1965 and were close to the goal of 1 per cent in 1966. If each developed market economy country had reached the target during 1966, additional net outflows of about $5 billion to developing countries and multilateral agencies would have been forthcoming. Some countries, notably Canada, Denmark, Japan, the Netherlands, and Sweden, have officially expressed their intent to reach the 1 per cent target. The Netherlands has set as its goal an official net flow equal to 1 per cent of its national income and Sweden intends to raise net official flows to 1 per cent of its GNP. Canada has expressed the intention of increasing foreign aid by 15 per cent per annum with the aim of reaching 1 per cent of GNP by 1970 or 1971.

74. But despite important efforts by some countries,

[37] See *World Economic Survey 1965, part I, op. cit.*, table IV-8.

the over-all aid picture is still disappointing. The current flows of assistance are inadequate by any reasonable standard — be it the capacity of developed countries to render assistance or the ability of recipient countries to make effective use of additional resources. If the current trends are to be reversed, official aid budgets and contributions to multilateral agencies must lead the way. This will require a basic change in current attitudes towards external assistance: instead of being regarded as a residual element in public budgets, aid should be accepted as an essential component of an effective international development policy.

DOCUMENT TD/7/SUPP.3 *

The terms of financial flows and problems of debt-servicing

Note by the secretariat of UNCTAD

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[18 October 1967]

Introduction

1. The flow of external resources to developing countries may be reviewed from the standpoint both of its volume and of its terms. Clearly the two aspects are interrelated, but it is convenient to examine them separately. This document is concerned primarily with the terms of aid: the question of volume and over-all adequacy is the subject of another paper, "Growth and external development finance".[1]

2. One of the main issues at the present time is that of the terms and conditions applied to the flow of resources. This is partly a question of repayment terms and interest rates, and of the debt-service problems generated thereby, but it concerns also other factors, notably the tying of assistance to particular projects or to purchases in particular countries.[2]

3. There is general agreement about the need to provide developing countries at the present time, and for a number of years to come, with an excess of imports over exports. The object of these additional resources from abroad is to make it possible for these countries to accelerate their rate of investment in new productive capacity—by adding to their ability to import capital goods and by supplementing domestic savings.

4. How long such a surplus of imports by developing countries could or should be maintained is more controversial. Some would say that the surplus is required only until the stage of "self-sustained growth" is reached, on some appropriate definition of that term, while others believe that the surplus should be prolonged beyond that point in order to narrow the gap in living standards between various groups of countries.

5. On either view, however, it is accepted that a surplus of imports by developing countries should be maintained for a considerable number of years ahead, and that, indeed, the surplus should be increased substantially above present levels to keep pace with the growing capacity of developing countries to make effective use of the additional resources.

6. If developing countries are to be enabled to import more than they export, the gross inflow of capital must be of such a magnitude as to cover not only this excess of imports but also the reverse flow of loan repayments and capital repatriation, interest, dividends and profits.

7. It is a matter of simple arithmetic that a given annual gross flow of loans, at given maturities and interest rates, will build up a progressively rising reverse flow of interest and amortization that will ultimately exceed the gross flow itself. Similar considerations apply to a given annual gross flow of direct investment capital with a relatively stable or rising rate of return; for even where direct investment is not followed at some subsequent date by capital repatriation, remittances of dividends and profits will increase progressively and will, at some stage, exceed the given annual gross flow. The ultimate effect of direct investment on the balance of payments of recipient countries may therefore be as great as, or greater than, that of loans requiring amortization.

8. The accumulation of debt by a developing country and the consequent incurring of service obligations need not cause difficulties in the growth process but should, in fact, promote it. The problem arises not from the need to service the debt but from the rate at which debt-service obligations are built up in relation to the capacity to meet such obligations. It is to be presumed that capital inflows, by stimulating economic growth, will in the long run tend to generate additional exports or replace imports. By this means, the resources will be provided for the service of debt.

9. Experience shows, however, that the short-run effects of accelerating growth may be to cause additional pressure on the balance of payments rather than the reverse. Indeed, the immediate result of the creation of new capacities and higher incomes may be to develop new import requirements, and it may be only in the longer run that a net saving of imports or a net addition to exports is actually realized.

10. Thus the vital question is whether the phasing of repayment and debt service by the developing countries corresponds to the rate at which they can make foreign exchange resources available for this purpose without detriment to the growth process. In practice the co-ordination of the terms and conditions of assistance with the growth of debt-servicing capacity has often been undertaken *ad hoc*, rather than within a long-term perspective of careful debt management and planning. Frequently it is only the pressure of unrealistic terms and conditions and the approach of a critical balance of payments situation that forces a reappraisal of debt-servicing capacity; whereas advance planning might have shown

* Incorporating document TD/7/Supp.3/Corr.1.

[1] See document TD/7/Supp. 1, to be found in this volume.

[2] See J. Bhagwati, "The tying of aid" (document TD/7/Supp.4), to be found in this volume.

that the foreign exchange resources required for debt-servicing were not likely to increase fast enough to warrant the terms and conditions originally estabished.

11. More generally, the evidence available appears to suggest that it would be unrealistic to expect the growth problem of developing countries to be resolved in a short space of time. The magnitude of the task involved in raising levels of living over the larger part of the earth's surface is such that the developing countries are likely to need a surplus of imports over exports for a considerable number of years ahead. It follows that the terms and conditions of capital flows to developing countries need to be such as to provide, at least during the next decade, for a substantial surplus of financial flows over all repayment and service obligations.

12. With a given annual gross flow of capital, the length of the period during which net resources are being transferred to developing countries will depend on the proportion of total gross flows not calling for any reverse payment an any time—namely, grants; on the interest rates and grace and amortization periods applied to loans; and on the rate of dividend and profit remittances on direct and portfolio investment.

13. The tendency to focus attention on gross flows of capital, or on flows that are net only of amortization and capital repatriation, is thus in danger of obscuring the really important question—namely how much is being added to the capacity of developing countries to import and to invest. It has been estimated that approximately one-half of the gross flow to developing countries is offset by amortization, interest and dividend payments and that the gross flow will continue to be offset by these payments at an accelerating rate if present terms continue.[3] Moreover, conservative projections by the UNCTAD secretariat show that the net flow of grants and loans will tend to decline unless gross flows rise sharply or terms soften considerably.[4] Indeed, a number of developing countries may even be required to transfer resources to developed countries in order to finance the excess of the service on capital over new gross inflow.

14. From a historical viewpoint it would, of course, be nothing new for capital flows to developing countries to be equalled or exceeded by reverse flows of service payments. During the 1920s, for example, the net increase in foreign investment by creditor countries was of a similar order of magnitude to the net payments of interest and dividends by debtor countries.[5] In the case of Latin America, annual net investment income during the later 1920s substantially exceeded the net capital inflow.[6]

15. The stability of the international economic framework of the 1920s depended on the exports of debtor countries rising sufficiently fast to permit the rapidly growing payments of interest and dividends to be made. In fact, however, exports rose much more slowly than service payments, so that the proportion of export earnings available to finance imports declined continuously. For all the differences between the present situation and that of the 1920s the similarities are too striking to be overlooked—the high interest rates on loans, the rapid rise in service payments by debtor countries, and the excessive reliance on short and medium-term debt.

16. As a United Nations study of this period pointed out:

> "The high return on the capital, however, was not an unmitigated advantage to the investors, since it contributed to undermining the balance of payments of the debtor countries and thus hastened and aggravated the collapse. The instability in the external transactions of debtor countries, only temporarily cloaked as long as foreign capital continued to enter, was all the more serious since a considerable part of that capital was lent on short or medium term."[7]

The subsequent collapse of the debtor countries under the impact of the decline in commodity prices during the depression and the drying up of international capital flows is a well-known historical fact. It is not, however, necessary to assume developments as drastic as those of 1929-1931 to see that at least as far as the balances of payments of the debtor countries are concerned, certain of the basic elements of inter-war instability appear to have recurred.

17. The issue of the terms and conditions of development assistance is thus a dual one: by what means would it be possible to reduce the vulnerability of the balances of payments of developing countries resulting from the growing service payments and the excessive dependence on short and medium-term credit? And by what means can the international community assure the transfer of an adequate volume of resources to developing countries?

18. The following discussion is divided into two main parts, A and B. The first reviews recent trends in the terms of assistance and the second discusses various possible measures to deal with outstanding problems.

A. Recent trends in the terms of assistance[8]

19. Current trends in the terms of assistance are such as to aggravate the problem of maintaining net transfers to developing countries at the desired levels. The proportion of grants and grant-like contributions in total

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[3] Annual address by Mr. George D. Woods, President of IBRD, to the Annual Meetings of the Boards of Governors of IBRD, the International Finance Corporation (IFC) and the International Development Association (IDA) (see IBRD-IFC-IDA, *Summary Proceedings, Annual Meetings of the Boards of Governors, 1965* (Washington, D.C. 1965), p. 11.

[4] See below "The outlook for debt service" (document TD/7/Supp. 5) to be found in this volume.

[5] *International Capital Movements during the Inter-War Period* (United Nations publication, Sales No.: 1949.II.D.2), p. 58.

[6] *Foreign Capital in Latin America* (United Nations publication, Sales No.: 54.II.G.4), table XXVI.

[7] *International Capital Movements during the Inter-War Period, op. cit.* p. 66.

[8] The figures given in this section are based on studies made by the Organisation for Economic Co-operation and Development (OECD) and therefore references are made to "developing countries" in the OECD sense of the term. The periods chosen for each section vary according to the information available.

official flows is falling, while the most recent data available show that in the year 1966 payments of interest and amortization by developing countries absorbed 45 per cent of gross official bilateral lending (which takes place on much softer terms than that from private sources) thus reducing the net transfer to developing countries.

Grants and grant-like contributions

20. As regards assistance not requiring repayment in convertible currency, table 1 shows that grants and grant-like contributions[9] have fallen from 80 per cent of gross official disbursements from the developed market economies in 1956 to 58 per cent in 1966. It follows, of course, that the average interest and repayment obligations corresponding to a given total of gross official disbursements have to that extent increased. Moreover, since 1962, grants and grant-like contributions have declined in absolute terms, from a peak of $4.7 billion in 1962 to $3.8 billion in 1966.

21. While the figures for grants based on disbursements reported by countries members of the Development Assistance Committee (DAC) of OECD show what actually occurred in past years, figures based on commitments give an indication of what may occur in future years. In the year 1966, there were three countries —Australia, Belgium and Norway—whose grants constituted over 90 per cent of their official commitments for that year (see table 2). The share of grants in total official commitments of four other countries —Canada, France, the Netherlands and Sweden—was above the 70 per cent level recommended by DAC. Of the remaining countries, there were declines from 1965 for Denmark, the Federal Republic of Germany, Italy, Portugal, the United Kinddom and the United States, and slight increases for Austria and Japan.

[9] "Grant-like contributions" include technical assistance, reparation and indemnification payments, loans payable in the recipients' currencies and the transfer of resources through sale for recipients' currencies.

Terms of lending

22. The obverse of the decline in the proportion of grants from DAC member countries is, of course, the rise in importance of official loan disbursements which, as shown in table 3, increased on a gross basis from $1,723 million in 1962 to $2,958 million in 1966. It also appears from table 3 that amortization payments averaged over 25 per cent of the annual loans extended during 1962-1966 and rose steadily from $423 million in 1962 to $823 million in 1966. When interest payments are included with amortization, the total absorbed over 40 per cent of official bilateral loans extended during the same period. Thus it took an increase of $1.2 billion in gross loan disbursements from 1962 to 1966 to achieve an additional net tranfer of $0.6 billion.

TABLE 1

Grants and grant-like contributions in relation to gross official disbursements of DAC member countries, 1956-1966

($U.S. million)

	1956	*1957*	*1958*	*1959*	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*
I. Total official disbursements, gross[a]	3.5	4.3	4.7	4.8	5.3	6.5	6.4	6.6	6.6	7.0	7.3
II. Total official disbursements, net	3.3	3.9	4.4	4.4	4.9	6.1	6.0	6.1	5.9	6.2	6.9
III. Grants and grant-like contributions[b] . .	2.8	3.2	3.5	3.5	4.3	4.6	4.7	4.4	4.3	4.2	4.2
(a) as percentage of gross official disbursements	80	75	74	72	80	70	73	67	65	61	58
(b) as percentage of net official disbursements	85	83	79	78	87	76	78	73	73	68	61

Sources: UNCTAD secretariat, based on OECD, *Development Assistance Efforts and Policies, 1967 Review*, (Paris 1967) and *The Flow of Financial Resources to Less-Developed Countries 1961-1965* (Paris, 1967).

[a] Including transactions in bonds, loans and participations on a net basis.

[b] Including grants, grant-like contributions and capital subscriptions and grants to multilateral agencies.

TABLE 2

Grants as percentage of official commitments and terms of loans for DAC member countries, 1964-1966

Country	*Grants and grant-like contributions as percentage of total official commitments*[a]			*Percentage of total value of loans at interest rates of 3 per cent or less*[b]			*Percentage of loan commitments with maturity periods of twenty-five years or more*[c]		
	1964	*1965*	*1966*	*1964*	*1965*	*1966*	*1964*	*1965*	*1966*
Australia[d]	100	100	100	e	e	e	e	e	e
Austria	21	14	16	6	14	10	—	—	—
Belgium	94	98	95	100	100	100	—	—	—
Canada	51	54	77	25	50	62	25	50	62
Denmark	77	70	63	—	—	100	—	—	—
Federal Republic of Germany	49	43	42	57	49	77	26	9	49
France	76	80	83	32	17	17	7	10	12
Italy	44	21	13	4	56	69	—	—	—
Japan	49	37	42	—	23	—	—	—	—
Netherlands	75	71	76	25	40	92	68	85	51
Norway	95	96	100	—	100	e	—	—	e
Portugal	18	29	19[d]	26	14	12	1	72	54
Sweden	80	89	77	100	100	100	—	—	—
United Kingdom	43	55	50	11	33	86	76	65	91
United States	58	62	61	74	54	68	74	56	59

Sources: UNCTAD secretariat, based on OECD, *Development Assistance Efforts and Policies: 1966 Review* (Paris, 1966) and *1967 Review, op. cit.*

[a] Official commitments include total bilateral and multilateral grant commitments, and loan commitments of one year or more.

[b] Computed by subtracting grants as percentage of total commitments from grants and loans at interest rates of 3 per cent or less as percentage of total commitments. The results were then related to loans which were calculated as the difference between grants and total commitments.

[c] Computed by finding the difference between grants as percentage of total commitments and grants and loans with maturity of twenty-five years or more as percentage of total commitments. The results were then related to loans as percentage of total commitments.

[d] Based on gross disbursement data.

[e] Not applicable.

TABLE 3

Official bilateral loan disbursements, amortization and interest received by DAC member countries, 1962-1966

($U.S. million)

	1962	*1963*	*1964*	*1965*	*1966*
Gross loan disbursements	1,723	2,143	2,273	2,718	2,958
Less: amortization received	423	466	694	759	823
Loans, net of amortization received	1,300	1,677	1,579	1,959	2,135
Less: interest received	294	316	421	450	494
Loans, net of interest and amortization	1,006	1,361	1,158	1,509	1,641
Interest and amortization as percentage of loan disbursements	42%	36%	49%	45%	45%

Sources: UNCTAD secretariat, based on OECD, *1966 Review, op. cit.*, statistical annex, pp. 150-151, and *1967 Review, op. cit.*

23. A further breakdown of interest and amortization in relation to gross lending for each DAC member country for the period 1963-1966 is given in table 4. A frequency distribution shows that, except for the Netherlands and Sweden, repayments on past official lending exceeded 25 per cent of new gross lending during the period 1963-1966. Results for the year 1966 show that six countries had interest and amortization receipts which exceeded 50 per cent of their gross official lending.

24. As regards official bilateral loan commitments of DAC member countries, weighted average interest rates have fluctuated between 3.6 and 3.0 per cent since 1962. They declined from 3.6 per cent in 1962 to 3.0 per cent in 1964. In 1965 they again rose to 3.6 per cent and then declined to 3.1 per cent in 1966.

TABLE 4

Frequency distribution of amortization and interest as a percentage of gross official bilateral lending of DAC member countries, 1963-1966 and 1966

Less than 25%	*25—50%*	*50—75%*	*75% and above*
	A. — *1963 - 1966*[a]		
Netherlands	Austria	United Kingdom	Belgium
Sweden	Canada		Italy
	Denmark		
	Federal Republic of Germany		
	France		
	Japan		
	Norway		
	Portugal		
	United States		
	B. — *1966*		
Denmark	Austria	Canada	Belgium
Netherlands	Federal Republic of Germany	France	Italy
Sweden	Japan	United Kingdom	Portugal
	Norway		
	United States		

Source: UNCTAD secretariat, based on OECD, *1967 Review, op. cit.*

[a] Total of interest and amortization for the years 1963-1966 as a percentage of gross official lending for the same period.

25. Table 2 also contains estimates of the percentages of loans granted at interest rates of 3 per cent or less by DAC member countries. On the basis of 1966 commitments, there were three countries—Belgium, Denmark and Sweden, all of whose loans were at 3 per cent or less. Six other countries were giving as much as one-half of their loans at 3 per cent or less—Canada, the Federal Republic of Germany, Italy, the Netherlands, the United Kingdom and the United States. On the other hand, Australia's assistance was entirely in the form of grants. While exact figures are not available, it is likely that there has been a substantial reduction in the proportion of bilateral loan commitments at interest rates of less than 1 per cent since 1962, mainly because of a rise in interest rates on United States development loans.

26. Weighted average maturity periods of new loan commitments of DAC member countries improved during the years 1962-1964, rising from approximately twenty-four to twenty-eight years. In 1965, however, the average declined to twenty-two years.[10] There was a slight improvement to twenty-four years in 1966.

27. There is, moreover, still a large percentage of loan commitments which have maturity periods of less than twenty years. While this percentage cannot be derived precisely from the available data, a rough estimate can be made for the percentage of loan commitments by each DAC member country with maturity periods of twenty-five years or more. The results are presented in table 2, from which it will be seen that many DAC members continue to require repayment in less than twenty-five years in a substantial number of cases. Six members have required all loans, for the years 1964-1966, to be repaid in less than twenty-five years.

28. Weighted average grace periods of loan commitments showed a decline from 6.0 years in 1964 to 5.3 years in 1966. In addition to the use of grace periods in respect of amortization, some countries have introduced interest waivers on loans.[11] While no systematic information has yet been collected on the magnitude of interest waivers, their effect can be substantial.[12]

29. To summarize recent developments, from 1962 to 1964 there was an increased reliance by the DAC member countries on loans, and the terms of these loans were softened somewhat. On balance, however, the improvement of terms may not have compensated for the decline which occurred in the percentage of gross official disbursements in the form of grants and grant-like contributions.[13] In 1965 there was a marked deterioration in the situation, since, while the proportion of grants continued to fall, the terms of loans hardened significantly. In 1966, the terms of official lending of DAC member countries improved slightly while the proportion of grants continued to decline.

[10] OECD, *1966 Review*, and *1967 Review*, *op. cit.*

[11] OECD, *Development Assistance Efforts and Policies, 1965 Review*, (Paris, 1965), p. 86.

[12] For example, in the case of a $1,000 loan at 3 per cent amortized equally over a twenty-year period (i.e., no grace period on amortization payments), the introduction of a seven-year interest waiver would reduce payments over the life of the loan from $315 to $136.50, a reduction of over 55 per cent.

[13] IBRD-IDA, *1965-1966, Annual Report*, p. 35.

30. While there was some improvement in terms of lending of DAC member countries in 1966, it is likely that the interest rates on lending from private sources to developing countries rose along with the general increase in interest rates which occurred in 1966. There has thus been little, if any, improvement as regards the over-all situation on financial terms; and a further deterioration may, in fact, have taken place during the past year.

31. Early in 1966 there was a rise in the lending rate of IBRD, from 5.5 per cent to 6 per cent per annum. The rise was due, in large part, to the increased costs of borrowing in "tight" financial markets, which in turn were influenced by balance of payments problems in the major financial centres. While the share of IDA loans in total disbursements of the IBRD group increased in 1966, the ability of the IBRD Group to continue offsetting the effect of higher borrowing costs in this way depends on the replenishment of IDA resources by governmental contributions.

32. Government credits under economic co-operation agreements from the socialist countries of Eastern Europe and Asia to developing countries have generally carried interest rates of 2.5 per cent or less, with maturities of ten to twelve years.[14] Commercial credits have somewhat higher rates of interest, which do not usually exceed 4 per cent annually, with maturities of three to eight years in most instances. The possibility of repaying credits in the form of exports of commodities from debtor countries, or in their national currencies, has been receiving increasing attention in recent years. The bulk of government credits are repaid in this form, which is also being used for the repayment of commercial credits in certain instances. In some cases, repayment has been made through the export of goods produced by plants built with the aid of foreign credits.[15] Repayment in the form of commodities helps to ease the balance of payments problems of borrowing countries provided that it is additional to the imports which the lending countries would have purchased in any event and if prices are set at remunerative levels.

External debt and debt-servicing requirements of developing countries

33. The entire aid picture is increasingly overshadowed by the mounting burden of external debt and debt-servicing requirements of developing countries. It is now six years since Eugene Black, then President of IBRD, warned of the danger that "the machinery of economic development could be overloaded with foreign debt until it sputtered to a halt amid half-built projects and mountains of discarded plans."[16] Nothing that has happened since that time has diminished the relevance of this statement—rather the reverse.

34. As recorded by IBRD, the external public debt of ninety-five developing countries increased from $10 billion in 1956 to $39.2 billion in 1965. Annual payments of interest and amortization over the same period rose from $0.8 billion to about $3.6 billion.

35. The IBRD data do not include figures for unguaranteed export credits, debt repayable at the option of the borrower in local currencies, or commercial arrears. If we further take into account the possibility that even the data on public and publicly guaranteed debt may be understated to some extent, the total outstanding debt of developing countries could well have exceeded $45 billion at the end of the year 1966 and debt service could have amounted to more than $5 billion.

36. An important factor contributing to debt-service problems in developing countries is the increased reliance by a number of countries on export credits obtained on relatively hard terms. For a sample of thirty-six countries accounting for nearly 80 per cent of the outstanding debt of developing countries at the end of 1965, service payments on suppliers' credits alone accounted for $1.1 billion or about 35 per cent of their total service payments of $3.1 billion.[17] Service payments on suppliers' credits amounted to 5 per cent of the value of exports, and for ten of these countries the ratios ranged from 5 to 20 per cent.[18] For the same thirty-six countries, the over-all ratio of external debt service to the value of exports in 1965 amounted to 14.5 per cent.[19]

37. The rapid growth in the volume of export credits is due partly to the keen competition among industrial countries to promote exports to developing countries. It is also due in part to the pressing need for capital on the part of the developing countries which makes them willing to borrow even on extremely hard terms.

38. Problems of debt-servicing are not limited to countries which have assumed excessive amounts of suppliers' credits or other loans with hard terms. Indeed, countries which have followed fairly cautious policies as regards external debt are also experiencing heavy debt service burdens.[20]

39. The over-all debt-service ratio of developing countries (i.e., the ratio of service payments to merchandise exports, f.o.b.) rose from less than 4 per cent in the mid-1950s to 9 per cent in 1965. Debt-service payments

[14] See "Review of trade relations among countries having different economic and social systems: report by the secretariat of UNCTAD" (*Official Records of the Trade and Development Board, Fifth Session, Annexes*, agenda item 9, documents TD/B/128 and Add. 1-3), part two (document TD/B/128), para. 28.

[15] *Ibid.* Some agreements, however, envisage the possibility of repayment in convertible currencies. See Sa'id El-Naggar, *Foreign Aid and the Economic Development of the United Arab Republic*, Princeton Near East Papers, Number 1 (Princeton University, N.J., Programm in Near Eastern Studies, 1965), p. 28.

[16] Annual address to the Annual Meetings of the Boards of Governors of IBRD and IMF (see IBRD-IMF, *Summary Proceedings, Annual Meetings of the Boards of Governors, 1961* (Washington, D.C., 1961), p. 12).

[17] See IBRD, *Suppliers' Credits from Industrialized to Developing Countries: A Study by the Staff of the World Bank* (Revised edition, Washington D.C., April 1967), annex V.

[18] *Ibid.*, p. 20.

[19] *Ibid.*

[20] Statement by Irving S. Friedman, Economic Adviser to the President of IBRD, to the United Nations Economic and Social Council, on 13 July 1967 (see *Official Records of the Economic and Social Council, Forty-third Session*, 1483rd meeting).

of a number of countries reached such critical proportions that it became necessary to reschedule them.

40. It should be borne in mind that the debt-service ratio represents an average of widely diverging experience. In some countries, borrowing for the support of development programmes is a relatively recent phenomenon and here debt-service ratios are still low. In a number of other countries, on the other hand, debt-service ratios are as high as 15-20 per cent or more; in Latin America, for example, approximately one-sixth of export earnings were pre-empted by debt service in 1965.

41. Conservative projections by the UNCTAD secretariat have shown that, if recent trends in the terms and composition of financial flows continue, total debt-service payments by developing countries will rise from $3.6 billion in 1965 to more than $10 billion by the year 1975 even if gross flows rise no more than would be required to maintain the 1965 net flow of financial resources.[21]

B. Improving the terms of aid

United Nations and DAC recommendations on financial terms

42. There has been an increasing awareness of the problem of terms of assistance among the developed countries as evidenced in the adoption by DAC in July 1965 of its recommendation on Financial Terms and Conditions.[22] Targets were established against which the performance of DAC members could be checked. It was recommended that by the year 1968 member countries extend 70 per cent of their total official assistance in the form of grants or grant-like contributions. Alternatively they should endeavour to attain the level of performance of DAC countries in the year 1964, described as follows:

> "A proportion of 81 per cent of total commitments was given either as grants or at 3 per cent and less interest charges. Considered from the standpoint of maturity, 82 per cent of total commitments comprised grants and loans with repayment periods of 25 years and more. The weighted average grace period of new loan commitments was about 7 years."[23]

A broadly similar recommendation was adopted by the General Assembly of the United Nations in its resolution 2170 (XXI), endorsing Economic and Social Council resolution 1183 (XLI), which recommends that "not later than by 1968" at least 80 per cent of assistance should be in the form of grants, together with loans at interest rates of 3 per cent or less, with a repayment period of twenty-five years or more; except that where countries provide 70 per cent or more of their total official assistance in the form of grants or grant-like contributions, this in itself should be regarded as full compliance with the target.

43. In the year 1966, Australia, Belgium, Canada, France, the Netherlands, Norway and Sweden met the above target, in so far as they were extending 70 per cent or more of their assistance in the form of grants or grant-like contributions. In addition to these countries, the United States and the United Kingdom met the target in so far as grants and loans at interest rates of 3 per cent or less and with maturities of twenty-five years or more exceeded 81 per cent of total commitments. Denmark and the Federal Republic of Germany complied with one provision of the target in that their combined grants and loans at interest rates of 3 per cent or less exceeded 81 per cent of their total commitments. Of the countries providing less than 70 per cent of their assistance in the form of grants, none reached the target of seven years as regards the weighted average grace period of loan commitments.

44. Harmonization of terms and conditions of assistance by developed countries is almost as important an objective as the softening of terms. This is because, as in the case of aid tying, the less liberal policies of some countries exert pressure on the more liberal policies of others. Any government contemplating a softening of terms is bound to reflect that in so doing it may merely be making it possible for recipient countries to meet the payments due on the hard loans extended by others. It is therefore vital to narrow the spectrum of rates and maturities, particularly by improving the performance of the least liberal donors.

45. The foregoing survey shows that while many countries now comply with some or all of the numerical objectives of the United Nations and DAC recommendations, the over-all record is still unsatisfactory. The Chairman of DAC has characterized the present situation on the terms of aid as unsustainable:

> "Equally important is the question of the terms of aid financing. The present position is unsustainable. It is impossible to maintain even the present net flow of assistance in the face of growing interest and amortization payments. And it seems inevitable that the external payments of some developing countries will collapse under the weight of external debt. In dealing with this problem, the choice is between a disorderly and an orderly fashion. In the first case, we merely continue on the present basis until payments crises arise in less-developed countries and then mount a series of refinancing operations. In the second, we seek to soften the terms of lending and to anticipate debt crises before they develop. The DAC is moving steadily, if slowly, along the second path. The Committee has set up international standards for the terms of aid; now, in co-operation with the IBRD and the IMF, it is improving advance warning data on indebtedness. We must continue further in this direction as rapidly as possible."[24]

46. Even full compliance with the DAC recommendation would not, however, prove adequate in the longer

[21] See below "The outlook for debt service" (document TD/7/Supp. 5), to be found in this volume.

[22] See OECD, *1965 Review*, *op. cit.* pp. 117-122.

[23] *Ibid.*, p. 119. The above discussion deals only with section C of the recommendation on Financial Terms and Conditions.

[24] See introductory statement to the meeting of 19-20 July 1967 of DAC, reproduced in an OECD press release, reported by the Bank for International Settlements, *Press Review* No. 144, 27 July 1967.

run. It is clear from projections of debt service by the UNCTAD secretariat that a higher proportion of grants and a closer approach to IDA-like terms on loans from DAC members and the socialist countries of Eastern Europe and Asia is needed to permit an adequate transfer of resources to developing countries and to prevent debt-service ratios from rising to critical levels.

47. The following proposals are therefore put forward for consideration as possible measures to increase the net flow of resources and to help limit the ill effects of existing debt service problems.

Improving the terms of official lending

48. In view of the sharp increase in the share of lending in total aid and the rapid growth in the flow of export credits, it is important that there be a substantial softening of terms on official lending. This could be achieved through agreement on a new target for terms which would go beyond the target for 1968 laid down by DAC and the General Assembly of the United Nations. Such a target might specify, for all developed countries, *(a)* the minimum percentage of official assistance to be given in the form of grants ; and *(b)* a separate minimum percentage of loans to be given on easy terms — namely at interest rates of 3 per cent or less, maturities of twenty-five years or more and grace periods of at least seven years.

Lowering of interest rates

49. One technique for increasing the net tranfer of resources and alleviating the debt burden of developing countries is the use of interest subsidies and interest rebates. In the past, both Italy and the Netherlands have been able to lower interest rates somewhat through the use of interest subsidies. An interest rebate financed by special budgetary provisions in the member countries of the European Economic Community (EEC) has permitted the European Investment Bank to lower interest charges to Greece, Turkey and associated developing countries.[26] Wider use of interest subsidies and interest rebates, in the lending policies of governments and multilateral organizations, is to be encouraged. Some countries have, in recent years, gone even further to meet the needs of developing countries and have initiated steps to grant loans entirely free of interest. They include Canada, Denmark and the United Kingdom. More than half of the new lending commitments of each of these countries for the year 1966 consisted of interest-free loans.

Rescheduling of debt

50. While a softening of terms may lead to a gradual easing of the situation in the long run, this cannot prevent a massive bunching of service payments in a number of countries during the next few years ; in these cases, only deliberate and planned rescheduling can avoid the onset of debt crises. The present process of rescheduling is very complicated and time-consuming, and gives rise to a good deal of uncertainty, tending to disrupt not only trade and payments but the inflow of capital and, indeed, the whole development process. Present rescheduling techniques are deliberately informal because of the understandable desire of creditor countries to avoid excessive recourse to rescheduling operations. Under current procedures, moreover, the end result is merely a general agreement between the creditors and the debtor country seeking relief, while the specific application of the general agreement has to be worked out through complicated bilateral arrangements between individual creditors and the respective debtor. Finally, arrangements of this type have hitherto tended to provide only a breathing space for the debtor country concerned, so that the crisis is postponed but not dissipated, and the debtor country continues to operate under the persistent threat of balance-of-payments pressure. Experience therefore suggests the need for more deliberate anticipation of crisis situations. The adoption of an early-warning system within an appropriate institutional framework would make it possible to take appropriate steps before the onset of debt crises make it necessary to resort to unnecessarily drastic measures. In addition, the terms of rescheduling should be such as not to interfere with the orderly operation of the process of development planning in debtor countries. Whenever appropriate, particularly when debt crises reflect structural problems rather than short-term balance of payments difficulties, grace periods applying to the principal and interest on rescheduled debt should not be less than seven years.

[25] See below "The outlook for debt servicing" (document TD/7/Supp. 5) to be found in this volume.

[26] See OECD, *1965 Review*, *op. cit.*, pp. 85-87.

DOCUMENT TD/7/SUPP.5 *

The outlook for debt service
Report by the secretariat of UNCTAD

[Original text : English]
[31 October 1967]

Introduction

1. The debt-service problems of the developing countries have been the subject of various studies and a cause for concern in both donor and recipient countries and international organizations. A study was prepared by the staff of the International Bank for Reconstruction and Development (IBRD) for the first session of the United Nations Conference on Trade and Development[1] and recommendations calling for easier terms of assistance have been adopted by the Conference at its first session,[2] by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD)[3] and the General Assembly of the United Nations (resolution 2170 (XXI)).

2. The debt service obligations of the developing countries were examined by the Committee on Invisibles and Financing related to Trade at its second session. The Committee, in its Agreed statement on the problems of development, expressed the view that " the indebtedness of developing countries, in particular their mounting debt service obligations, is a matter of serious concern and threatens to lead to a significant diminution of the net transfer of resources. "[4]

3. Recent studies have confirmed the need for a softening of terms. In 1965, a study by the United States Agency for International Development (USAID) noted the large role of lending in development finance and concluded that softer terms constituted " the only practical solution for maintaining the net resource flow needed. "[5]

4. A more recent study of debt service has gone even further in its conclusions :

" But if terms of development loans cannot be softened drastically and universally, and this does not at present seem very likely, then one must probably look forward to an era of consolidation exercises, threats of default and eventually increasingly insistent demands for moratoria. Conceivably, a case may be made for loans which, in some distant future, when take-off has been reached by some borrowers, are repaid in the form of assistance to those who need it more. It is unlikely, however, that we shall even see that day without first having been forced to drastic adjustments of those claims and obligations which are currently being amassed, and probably the time is not far away when a concerted effort has to be made to put development assistance not merely on a soft, but on a grant basis. "[6]

5. During the past decade there has been a substantial rise in the external debt outstanding of developing countries and, of more immediate concern, in the service payments on this debt. According to the most recent IBRD figures, the external public debt outstanding (disbursed and undisbursed) of ninety-five developing countries[7] rose from approximately $10 billion in 1956 to $39.2 billion in 1965. The rate of increase in the payments of interest and amortization on this debt was even greater, payments advancing from $0.8 billion in 1956 to $3.6 billion in 1965.[8]

6. When allowance is made for unreported suppliers' credits and commercial arrears, the over-all amount of debt outstanding at the end of 1965 was probably in excess of $45 billion. The service payments associated with these additional debts may be relatively large because of their short-term character. When unreported suppliers' credits and commercial arrears are taken into account, interest and amortization due may well have exceeded $5 billion in the year 1965.

7. Capital inflow should assist in the development of a country's resources and, in the long run, help the

* Incorporating document TD/7/Supp. 5/Corr. 1.

[1] See IBRD, " Economic growth and external debt — a statistical presentation " (*Proceedings of the United Nations Conference on Trade and Development*, vol. V, *Financing and Invisibles — Institutional Arrangements* (United Nations publication, Sales No. : 64.II.B.15), p. 108.

[2] Recommendations A.IV.4 and A.IV.5. (See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No. : 64.II.B.11), pp. 44-46.)

[3] See OECD, *Development Assistance Efforts and Policies, 1965 Review* (Paris, 1965), annex B, pp. 117-122.

[4] See *Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3* (TD/B/118/Rev. 1), annex II, section E, para. 13.

[5] USAID, *A Study on Loan Terms, Debt Burden and Development* (Washington, D.C., 1965), p. 38.

[6] See Goran Ohlin, *Aid and Indebtedness — The Relation between Aid Requirements, Terms of Assistance and Indebtedness of Developing Countries* (Paris, OECD, 1966), p. 34.

[7] Including the countries of southern Europe.

[8] The estimate of $39.2 billion for debt outstanding and the estimate of $3.6 billion for debt service are the most recent figures available from IBRD for existing debt of public authorities or guaranteed by public authorities in debtor countries outstanding as of 1 January 1966.

growth of exports or provide substitutes for imports. The inflow should therefore in due course generate the foreign exchange earnings or savings necessary to service the debt. But this development may in many instances require a considerable number of years, while in the shorter run the pressure of development needs upon the balance of payments may grow rather than diminish. There is thus a danger that interest and repayment obligations may build up faster than the capacity to release foreign exchange to meet these obligations.

8. A widely-used indicator of a country's vulnerability to external debt crises is the ratio of debt service to merchandise exports. Since the mid-1950s the over-all ratio for developing countries has more than doubled, rising from less than 4 per cent in 1956 to 9 per cent in 1965.[9]

9. While the over-all ratio reached 9 per cent in 1965, for a number of developing countries the ratio was much higher. For Latin American countries as a group, for example, interest and amortization payments were equivalent to about one-sixth of export earnings.

10. Difficulties in meeting debt-service payments have in a number of cases already necessitated the rescheduling or consolidation of external debt. Indications are that instances of this type will tend to multiply over the coming years unless policies with respect to the volume and terms of capital flows to developing countries are substantially improved.

Debt-service projections

11. Two main sets of illustrative projections of the external debt and debt-service payments of developing countries have been made on various assumptions about the terms, volume and composition of financial flows for the period 1966-1975. The projections are made on a regional level and are based on an over-all initial debt outstanding of \$29.9 billion at the end of the year 1965. The estimate of \$29.9 billion represents the disbursed portion of the initial debt outstanding, including an adjustment for unguaranteed suppliers' credits.[10] The undisbursed portion of the initial debt outstanding is omitted to avoid the double counting of old and new debt, since new debt is estimated on the basis of disbursements. A breakdown of the initial debt outstanding by region is given in annex I below.

12. The interest and amortization payments falling due from 1966 to 1975 have two components: *(a)* payments on the initial debt outstanding as of 1 January 1966; *(b)* service payments on new loans contracted during the projection period itself. As regards debt service on the initial outstanding debt, future interest and amortization payments on the \$28.3 billion have been estimated on the basis of IBRD data.[11] The remaining \$1.6 billion of unguaranteed suppliers' credits outstanding is assumed to have a maturity of two years and an interest rate of 8 per cent. Service payments on new loans including suppliers' credits in the projections are on an annual basis and do not begin until the year 1967.

13. The time profile of service payments on new gross inflows of grants and loans for the year 1966-1975 would depend on the volume of such inflows as well as their composition. In this study, the assumption is that the composition of new gross inflows during the projection period for the most part would correspond to that of 1965 flows, as indicated by official sources.[12] However, in the second set of projections, suppliers' credits are assumed to rise at 5 per cent annually.

14. The estimates for suppliers' credits have a substantial influence on the results of the projections because of the short-term maturities and high interest rates involved.[13] New suppliers' credits and the service payments on these credits are therefore shown separately in the tables which follow.

15. For lack of information, no allowance has been made for return flows of profits and dividends on private capital and, for the most part, for debt service for military assistance, for commercial arrears and for unreported debt. Nor has allowance been made for the substantial repayments of developing countries due to the International Monetary Fund (IMF).

Constant gross inflow

16. The first set of projections shows the net inflow of resources and net lending on the assumption that the gross inflow of grants and loans to each region were to remain constant at its 1965 level throughout the projection period. The figures given for "net lending" are net both of interest and of amortization. The same applies to the net inflow of resources which consists of net lending plus grants.

17. It can be seen from table 1 that if the annual gross inflow of resources[14] were maintained at \$11 billion—the level estimated for the year 1965—then the net

[9] The over-all ratio would have been even higher had there not been an acceleration in the rate of increase of exports of developing countries as a whole during the period 1960-1965.

[10] Thus it is assumed that of the initial reported debt outstanding of \$39.2 billion at the end of the year 1965, \$28.3 billion was actually disbursed. Unguaranteed suppliers' credits outstanding at the end of 1965 are assumed to be of the order of \$1.6 billion.

[11] The methodology used in arriving at the figures given above and in the tables which follow is discussed in detail in annex I.

[12] See annex I, table A-1. Estimates for the composition of new loans and grants for the year 1965 are as follows: grants and grant-like contributions of \$4.09 billion, gross official lending by countries members of the Development Assistance Committee (DAC) of \$2.7 billion, gross official lending by the socialist countries of Eastern Europe and Asia of \$0.35 billion, gross multilateral lending of \$0.91 billion and gross suppliers' credits of \$3 billion. An estimate of the flow of grants and gross lending to developing countries by region is given in annex I, table A-1.

[13] The interest rates on suppliers' credits used in the projections—6 per cent for guaranteed credits and 8 per cent for unguaranteed credits—are nominal rates of interest. These may be considerably below the effective rates of interest, which often exceed 10 per cent.

[14] The gross inflow of resources consists of grants plus gross lending.

inflow of grants and loans for developing countries as a whole decline from $5.9 billion in 1966 to $3.6 billion in 1975. The regions of Africa and Asia and the Middle East show a decline of $1 billion each in the net inflow of resources from 1966 to 1975. While the declines in net inflow are less for the countries of Latin America and Europe in absolute terms, the net inflow for both these regions was already low in 1966.

18. During the period 1966-1975, total net lending would decline by more than $2 billion and would become negative by the year 1970. The sharpest declines in net lending would occur for Africa and for Asia and the Middle East, though for the latter region as a whole net lending would still be positive by 1975. For Latin American countries as a whole, net lending is already negative in the first year of the projection period.

Constant net inflow

19. It is to be expected, however, that the net flow of grants and loans would not be allowed to fall from its 1965 level. A second set of projections therefore assumes that the net flow to each region will remain constant at its 1965 level during the projection period and shows the gross inflow required to maintain that net flow.

20. It can be seen from table 2 that if the annual net inflow is to be maintained at $7.1 billion the gross inflow required would rise from $12.2 billion in 1966 to $17.5 billion by the year 1975.[15] Gross lending would have to rise from $8.1 billion in 1966 to $13.4 billion by by 1975, a rise of 60 per cent during the projection period, assuming that grants remain at $4.1 billion annually. The largest rise would occur for the countries of Africa, where borrowing requirements for the year 1975 would double from the 1966 level.

21. Debt-service payments for developing countries as a whole would more than double from $5.1 billion in 1966 to $10.4 billion in 1975. It can be seen from table 2 that if 1965 terms were to continue, service payments

[15] As noted earlier, suppliers' credits are assumed to rise at a rate of 5 per cent annually. In recent years suppliers' credits have been increasing substantially faster than 5 per cent. Projections by the UNCTAD secretariat show that if suppliers' credits are assumed to rise at 7 per cent annually, both debt service and gross inflow in 1975 will rise by an additional $0.5 billion when compared with the figures in table 2.

TABLE 1

Annual net inflow corresponding to a given gross inflow of financial resources, 1966-1975 [a]

($U.S. billion)

	Asia and Middle East [b]			*Latin America* [c]			*Africa* [d]			*Europe* [e]			*Total*		
	1966	*1970*	*1975*	*1966*	*1970*	*1975*	*1966*	*1970*	*1975*	*1966*	*1970*	*1975*	*1966*	*1970*	*1975*
1. Gross inflow	4.6	4.6	4.6	2.6	2.6	2.6	2.9	2.9	2.9	0.9	0.9	0.9	11.0	11.0	11.0
of which:															
(a) Grants .	2.1	2.1	2.1	0.6	0.6	0.6	1.4	1.4	1.4	0.1	0.1	0.1	4.1	4.1	4.1
(b) Gross lending	2.5	2.5	2.5	2.1	2.1	2.1	1.5	1.5	1.5	0.9	0.9	0.9	7.0	7.0	7.0
of which: Suppliers' credits . .	0.8	0.8	0.8	1.0	1.0	1.0	0.8	0.8	0.8	0.4	0.4	0.4	3.0	3.0	3.0
2. Total debt service [f] .	1.4	2.2	2.4	2.3	2.3	2.4	0.8	1.6	1.8	0.6	0.9	0.9	5.1	7.0	7.5
of which: Suppliers' credits . .	—	0.7	1.0	—	0.9	1.2	—	0.7	1.0	—	0.3	0.5	—	2.6	3.6
3. Net inflow [g] .	3.2	2.4	2.2	0.4	0.3	0.2	2.1	1.3	1.1	0.3	—	—	5.9	4.0	3.6
of which: Suppliers' credits . .	0.8	0.1	−0.2	1.0	0.1	−0.2	0.8	0.1	−0.2	0.4	0.1	−0.1	3.0	0.4	−0.7
4. Net lending [h]	1.1	0.2	0.1	−0.2	−0.3	−0.4	0.7	—	−0.2	0.2	—	—	1.8	−0.1	−0.5
5. Debt outstanding [i].	12.2	17.0	21.2	10.2	11.8	13.5	5.8	8.5	9.7	3.3	4.5	5.4	31.5	41.8	49.9

Sources: UNCTAD secretariat estimates, using IBRD projected service payments of existing debt of public authorities or guaranteed by public authorities in debtor countries. Sources for the amount and terms of each flow are given in the tables in annex I.

[a] Minus sign indicates excess of repayments over new inflow.

[b] Includes the following countries: Afghanistan, Burma, Cambodia, Ceylon, China (Taiwan), Hong-Kong, India, Indonesia, Iran, Iraq, Israel, Jordan, Kuwait, Laos, Lebanon, Malaysia, Nepal, Pakistan, Philippines, Republic of Korea, Republic of Viet-Nam, Saudi Arabia, Singapore, Syria, Thailand, Yemen.

[c] Includes the following countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana (ex-Br. Guiana), Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, Venezuela.

[d] Includes the following countries and territories: Algeria, Botswana, Burundi, Cameroon, Central African Republic, Chad, Congo (Kinshasa), Dahomey, Ethiopia, Gabon, Ghana, Guinea, Ivory Coast, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Morocco, Mozambique, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, Somalia, Rhodesia, Sudan, Swaziland Tanzania (ex-Tanganyika), Togo, Tunisia, Uganda, United Arab Republic, Upper Volta, Zambia.

[e] Includes the following countries: Cyprus, Greece, Malta, Spain, Turkey, Yugoslavia.

[f] Includes estimates of amortization and interest on old debt as well as on new gross lending during the projection period.

[g] Grants and grant-like contributions plus net lending.

[h] Net of interest and amortization.

[i] End-of-year figure.

TABLE 2

Annual gross inflow required to maintain a given net inflow with an assumed rate of growth of suppliers' credits, 1966-1975[a]

($U.S. billion)

	Asia and Middle East[b]			Latin America[b]			Africa[b]			Europe[b]			Total		
	1966	1970	1975	1966	1970	1975	1966	1970	1975	1966	1970	1975	1966	1970	1975
1. Gross inflow[c] . .	4.9	6.0	6.7	3.0	3.3	4.0	3.1	4.1	4.9	1.1	1.5	1.9	12.2	14.9	17.5
of which:															
(a) Grants .	2.1	2.1	2.1	0.6	0.6	0.6	1.4	1.4	1.4	0.1	0.1	0.1	4.1	4.1	4.1
(b) Gross lending .	2.8	3.9	4.6	2.5	2.8	3.4	1.8	2.7	3.6	1.1	1.4	1.8	8.1	10.8	13.4
of which: Suppliers' credits . .	0.8	1.0	1.3	1.0	1.3	1.6	0.8	1.0	1.3	0.4	0.5	0.7	3.2	3.8	4.9
2. Total debt service . .	1.4	2.5	3.2	2.3	2.5	3.2	0.8	1.7	2.6	0.6	1.0	1.4	5.1	7.8	10.4
of which: Suppliers' credits . .	—	0.8	1.4	—	1.0	1.7	—	0.8	1.4	—	0.4	0.7	—	2.9	5.1
3. Net inflow .	3.5	3.5	3.5	0.8	0.8	0.8	2.3	2.3	2.3	0.5	0.5	0.5	7.1	7.1	7.1
of which: Suppliers' credits . .	0.8	0.2	—	1.0	0.3	−0.1	0.8	0.2	—	0.4	0.1	—	3.2	0.9	−0.2
4. Net lending	1.4	1.4	1.4	0.2	0.2	0.2	1.0	1.0	1.0	0.4	0.4	0.4	3.0	3.0	3.0
5. Debt outstanding .	12.5	20.9	31.9	10.6	14.1	19.4	6.0	11.5	19.5	3.5	6.2	9.9	32.6	52.7	80.7

Sources: See table 1.

[a] Minus sign indicates excess of repayments over new inflow.

[b] Country and territory coverage for each region is the same as in table 1.

[c] Inflows, debt service and debt outstanding are defined as in table 1. Suppliers' credits are assumed to grow at an annual rate of 5 per cent for each region. The proportions in which the remainder of gross lending is assumed to increase are given in annex I, table A-2.

TABLE 3

Debt service as percentage of gross inflow and merchandise exports, f.o.b., 1966-1975

	Asia and Middle East[a]			Latin America[a]			Africa[a]			Europe[a]			Total		
	1966	1970	1975	1966	1970	1975	1966	1970	1975	1966	1970	1975	1966	1970	1975
1. Debt service as percentage of gross inflow	29	41	48	75	77	81	26	43	53	56	67	73	42	52	60
2. Debt service as percentage of exports, assuming that exports grow at an annual rate of															
(a) 4 per cent	9	13	14	19	17	18	10	18	22	17	24	28	13	16	18
	12[b]	18[b]	19[b]	23[c]	21[c]	22[c]	11[d]	20[d]	25[d]				16[e]	21[e]	23[e]
(b) 5 per cent	9	13	13	19	17	17	10	17	20	17	24	26	13	16	17
	12[b]	18[b]	18[b]	23[c]	20[c]	21[c]	11[d]	19[d]	23[d]				16[e]	20[e]	21[e]

Sources: UNCTAD secretariat estimates, based on table 2 and IMF, *International Financial Statistics*, Vol. XX, No. 7 (Washington, D.C., 1967).

[a] Defined as in table 1. Estimates of merchandise exports for 1966 were as follows: Asia and Middle East $16.2 billion; Latin America $12.4 billion; Africa $8.3 billion Europe $3.5 billion. In each case where a country was excluded from regional totals, it was assumed that the annual debt-service payments of the country to total service payments for the region were in the same proportion as the total debt outstanding of the country to that of the region.

[b] Excludes Iran, Iraq, Kuwait and Saudi Arabia.

[c] Excludes Venezuela.

[d] Excludes Libya.

[e] Excludes Iran, Iraq, Kuwait, Libya, Saudi Arabia and Venezuela.

TABLE 4

Annual gross inflow required to maintain a given net inflow on IDA-like terms, 1966-1975 [a]

($U.S. billion)

	Asia and Middle East [b]			Latin America [b]			Africa [b]			Europe [b]			Total		
	1966	*1970*	*1975*	*1966*	*1970*	*1975*	*1966*	*1970*	*1975*	*1966*	*1970*	*1975*	*1966*	*1970*	*1975*
1. Gross inflow [c] . .	4.9	5.6	5.6	3.0	2.9	3.0	3.1	3.9	4.1	1.1	1.3	1.3	12.2	13.7	14.0
of which:															
(a) Grants .	2.1	2.1	2.1	0.6	0.6	0.6	1.4	1.4	1.4	0.1	0.1	0.1	4.1	4.1	4.1
(b) Gross lending [d].	2.8	3.5	3.5	2.5	2.4	2.4	1.8	2.5	2.7	1.1	1.2	1.3	8.1	9.7	9.9
of which: Suppliers' credits . .	0.8	1.0	1.3	1.0	1.3	1.6	0.8	1.0	1.3	0.4	0.5	0.7	3.2	3.8	4.9
2. Total debt service . .	1.4	2.1	2.1	2.3	2.2	2.2	0.8	1.6	1.8	0.6	0.8	0.8	5.1	6.6	6.9
of which: Suppliers' credits . .	—	0.8	1.4	—	1.0	1.7	—	0.8	1.4	—	0.4	0.7	—	2.9	5.1
3. Net inflow .	3.5	3.5	3.5	0.8	0.8	0.8	2.3	2.3	2.3	0.5	0.5	0.5	7.1	7.1	7.1
of which: Suppliers' credits . .	0.8	0.2	—	1.0	0.3	−0.1	0.8	0.2	—	0.4	0.1	—	3.2	0.9	−0.2
4. Net lending.	1.4	1.4	1.4	0.2	0.2	0.2	1.0	1.0	1.0	0.4	0.4	0.4	3.0	3.0	3.0
5. Debt outstanding .	12.5	20.4	29.8	10.6	13.6	17.1	6.0	11.3	18.0	3.5	6.0	9.0	32.6	51.3	73.9

Sources: See table 1.

[a] Minus sign indicates excess of repayments over new inflow.

[b] Country and territory coverage for each region is the same as in table 1.

[c] Inflows, debt service and debt outstanding are defined as in table 1. Suppliers' credits are assumed to grow at an annual rate of 5 per cent for each region. The proportions in which the remainder of gross lending is assumed to increase are given in annex I, table A-3.

[d] Gross official bilateral lending, gross lending from the socialist countries of Eastern Europe and Asia and gross multilateral disbursements are assumed to be on IDA-like terms, i.e. interest rate of 0.08 per cent, 50-year maturity, 10-year grace period. The terms of guaranteed and ungaranteed suppliers' credits are the same as in tables 1 and 2 and are given in annex I.

during the projection period would triple for the countries of Southern Europe and of Asia and the Middle East. For the countries of Latin America, where service payments were already the highest of any region at the beginning of the projection period, there would be additional service payments of nearly $1 billion by the year 1975.

22. The significance of the rise in debt service which results from the projections given above is shown in table 3. If exports were to rise at an average annual rate of 4 per cent during the period, by the year 1975 an over-all average of 18 per cent of export earnings would be pre-empted by debt-service payments, assuming that present average terms are maintained.[16] If the countries exporting petroleum are excluded, debt service would correspond to 23 per cent of export earnings in 1975, on the same assumptions. Such an average would probably imply a significant number of cases in which countries would be allocating as much as 30 per cent or more of their export earnings to debt service, placing them in an exceedingly precarious balance of payments position. The only region for which a decline in the debt service ratio is shown in table 3 is Latin America. This is a consequence of the assumption underlying the projections of keeping the net inflow of grants and loans constant at their 1965 level. It can be seen from table 2 that the net lending of $200 million in 1966 to be maintained for Latin America was already the lowest of any region. The gross lending and the corresponding service payments will, *ceteris paribus*, be lower as the net lending to be maintained constant over the projection period is less.

23. It can be seen from table 3 that, for each region, debt service as a percentage of gross inflow rises considerably from 1966 to 1975. The largest increase occurs for the countries of Africa, where the figure rises from 26 per cent in 1966 to 53 per cent in 1975. In Latin America approximately 80 per cent of grants and loans would be offset by service payments in 1975.

24. The projections assume that the 1965 terms of loans will not alter over the next decade. The situation could, however, be improved if there were a general softening of terms or a rise in grants.

[16] Exports by developing countries of commodities other than petroleum and manufactures are expected to increase at an average rate of less than 4 per cent per annum during the period up to 1975. See *Trade prospects and capital needs of developing countries* (United Nations publication, Sales No.: E.68.II.D.13).

25. The extent of such improvement can be shown by assuming that all new official lending (excluding suppliers' credits) were to take place on soft terms similar to those offered by the International Development Association (IDA) (see table 4 above). If this were to occur, the gross inflow required to maintain a net inflow of $7.1 billion would rise to $14 billion in 1975, over $3 billion less than would be required on 1965 average terms.[17]

26. The rise in total debt service would also be substantially lower. Whereas debt service would rise to $10.4 billion on present average terms, if new official lending were to be on IDA-like terms, debt service would rise to $6.9 billion in 1975, of which more than $5 billion would be attributable to the flow of new suppliers' credits during the projection period.

27. Further disaggregation of the terms of gross lending beyond that given in table 2 would probably lead to an increase in the estimate of gross inflow required and of the service payments of each region. A partial disaggregation of official bilateral and multilateral lending on a regional basis results in an increase in the gross inflow required of over $1 billion and an increase in debt service of more than $1 billion in 1975.[18] It could well be the case that if the projections could take into account the actual stream of repayments of each country on new lending during the projection period, the over-all gross inflow required and the total service payments would rise by an additional $1 billion or more, over and above the increase which results from the partial disaggregation referred to above.[19]

28. The foregoing projections are made on a regional basis and do not distinguish between countries requiring loans on concessional terms and those which are able to borrow on commercial terms without serious difficulty. Because of this regional approach the projections fail to make allowance for the uneven distribution of suppliers' credits, except in so far as this uneven distribution is reflected in the aggregates for the respective regions.[20]

29. The findings of the study thus indicate a rapid build-up of debt-service payments at present, or harder terms and a substantial easing of the situation when lending is assumed to take place on soft terms. The projections assume that the new inflow of grants and loans can be used to service debt. Grants, however, seldom take the form of convertible currency and loans are, more often than not, tied and cannot be used to service past debts. The burden of servicing the future debt of developing countries is therefore most likely to fall upon the export earnings of the debtor countries.

[17] Since IDA-like terms include a ten-year grace period, there would be a somewhat more rapid rate of increase in gross inflows required after 1975.

[18] See annex II below for estimates of gross inflow and debt service corresponding to constant (1965) net flow using weighted average terms for developing countries as a whole.

[19] The effect of disaggregation can be illustrated by an extreme example regarding the maturity of loans of equal amounts. If there are two loans of $100 each and one has a maturity of fifty years and the other a maturity of two years, their weighted average maturity is twenty-six years. A weighted average maturity of twenty-six years does not, however, reflect the fact that the second loan would be fully amortized after two years.

[20] Estimates of net flows of export credits for the years 1960-1964 are given in OECD, *Geographical Distribution of Financial Flows to Less-Developed Countries—1960-1964* (Paris, 1966). The figures show only the net change in guaranteed private export credits of each recipient country; since no information on interest and amortization is given, the country distribution of the gross flows of export credits cannot be deduced. Most of the limitations of the regional approach noted above would be overcome if the study were able to proceed on an individual country basis and if it were able to differentiate between projected service payments on the initial debt outstanding, both as regards export credits and as regards official lending.

ANNEXES

Annex I

Methodology

1. Two main sets of projections of external debt and debt service payments have been made at the regional level for ninety-five developing countries for the period 1966-1975. The first set of projections assumes that the gross inflow of grants and loans during the period 1966-1975 for each region would remain constant at its 1965 level and examines the resulting decline in the inflow of grants and loans net of amortization and interest if terms for the year 1965 were to continue. The second set of projections assumes that the net inflow of grants and loans for each region during the period 1966-1975 is to be maintained at its 1965 level and examines the amount by which the gross inflow of grants and loans would have to rise if 1965 terms were to continue.

2. Each projection is based on an initial debt outstanding of $29.9 billion as of 31 Dezember 1965. This figure consists of two components: unguaranteed suppliers' credits outstanding and an estimate of the disbursed part of total reported debt. It was arrived at in the following manner: unguaranteed suppliers' credits outstanding are estimated to be approximately $1.6 billion and are divided as follows: Latin America $0.6 billion; Asia and Middle East $0.4 billion; Africa $0.4 billion; Southern Europe $0.2 billion. Total reported debt (disbursed and undisbursed) of $39.2 billion is divided as follows: Latin America $11.7 billion; Asia and Middle East $16.5 billion; Africa $6.9 billion; Southern Europe $4.1 billion.[a] In order to

[a] See IBRD, *Suppliers' Credits from Industrialized to Developing Countries: A Study by the Staff of the World Bank* (Washington, D.C., 1967), annex V. The above totals for Africa and for Asia and the Middle East differ from those reported by IBRD since in the figures given above, the United Arab Republic is included in Africa rather than in the Middle East as in annex V of the IBRD study.

separate the disbursed from the undisbursed debt, it was estimated that the undisbursed debt consisted of the following proportions of the total debt outstanding: Latin America 16 per cent; Asia and Middle East 35 per cent; Africa 30 per cent; Southern Europe 28 per cent.[b] Total reported debt (disbursed) was therefore estimated at $28.3 billion, which was divided as follows: Latin America $9.9 billion; Asia and Middle East $10.7 billion; Africa $4.7 billion; Southern Europe $2.9 billion. Regional estimates of service payments on existing debt for sixty-one developing countries by IBRD for the years 1966-1975 were extrapolated to give regional totals for ninety-five countries on the assumption that the ratio of interest and amortization to total debt outstanding for the ninety-five countries would be the same as for the sixty-one countries included in the IBRD's estimates. Service payments were then adjusted to omit payments on undisbursed debt assuming the average terms of undisbursed debt to be 3.5 per cent interest, a five-year grace period and twenty-five years maturity. It is assumed that the $1.6 billion of unguaranteed suppliers' credits have a maturity of two years and an interest rate of 8 per cent. For lack of information, no allowance was made for return flows of profits and dividends on private capital and, for the most part, for debt service for military assistance, for commercial arrears and for unreported debt. Nor was allowance made for the substantial repayments of developing countries due to IMF.

3. The composition of new gross inflows during the projection period is assumed for the most part to correspond to that of 1965 flows, as given in table A-1. The allowance made for suppliers' credits has a substantial influence on the results of the projections because of the short-term maturities and high interest rates involved. New suppliers' credits and the service payments on those credits are therefore shown separately in each table.[c] It should be noted that the figures for new export credits are limited to suppliers' credits alone since no official estimates of financial credits were available.[d]

4. As regards the terms of new gross lending the following average terms have been used for all regions as regards suppliers' credits:

(a) *Officially guaranteed suppliers' credits:* 6 per cent interest, one-year grace period, six years maturity;

(b) *Unguaranteed suppliers' credits:* 8 per cent interest, no grace period, two years maturity.

[b] The above figures are, for the most part, similar to those given by IBRD for forty-nine countries. See IBRD-IDA, *Annual Report 1966/1967*.

[c] They are assumed to rise at 5 per cent annually in the second set of projections.

[d] Figures given for gross disbursements by the Inter-American Development Bank (IDB) were adjusted to exclude estimates of the amounts repayable in local currencies.

TABLE A-1

Estimate of grants and gross lending to developing countries for the year 1965

($U.S. billion)

Region	*Grants*	*Suppliers' credits*		*Gross official bilateral lending of DAC members*	*Gross multilateral lending*			*Gross lending of socialist countries*	*Total*
		Guaranteed	*Unguaranteed*		*IBRD-International Finance Corporation (IFC)*	*IDA*	*IDB*		
Latin America[a]	0.55	0.75	0.25	0.7	0.21	0.02	0.15	—	2.63
Asia and Middle East[b]	2.12	0.6	0.2	1.2	0.14	0.24	—	0.1	4.60
Africa[c]	1.35	0.6	0.2	0.4	0.08	0.01	—	0.25	2.89
Southern Europe[d]	0.07	0.3	0.1	0.4	0.05	0.01	—	—	0.93
TOTAL	4.09	2.25	0.75	2.7	0.48	0.28	0.15	0.35	11.05

Sources: UNCTAD secretariat estimates, based on: United Nations, *World Economic Survey, 1965*, Part I, *The Financing of Economic Development* (United Nations publication, Sales No.: 66.II.C.1 and Corrigendum); submissions by Governments and international organizations to "Review of international trade and development, 1966: report by the Secretary-General of UNCTAD" (*Official Records of the Trade and Development Board, Fourth Session, Annexes*, agenda item 3, documents TD/B/82 and Add.1-4); IBRD-IDA, *1965-1966 Annual Report* (Washington, D.C., 1966) and *1966/1967 Annual Report* (Washington, D.C., 1967); IBRD, *Suppliers' Credits from Industrialized to Developing Countries, op. cit.*; Inter-American Development Bank, *Sixth Annual Report 1965*; OECD, *Geographical Distribution of Financial Flows to Less-Developed Countries, 1960-1964, op. cit.*, *Geographical Distribution of Financial Flows to Less-Developed Countries, 1965* (Paris, 1967); *The Flow of Financial Resources to Less-Developed Countries, 1961-1965* (Paris, 1967); *Development Assistance Efforts and Policies—1965 Review, op. cit.*; *1966 Review* (Paris, 1966); Canada, External Aid Office, *A Report on Canada's External Aid Programs, Fiscal Year 1965-1966*; United Kingdom, Ministry of Overseas Development, *Overseas Development: The Work in Hand* (London); USAID, *Proposed Economic Assistance Program for 1966: Summary Presentation to Congress* (Washington, D.C., U.S. Government Printing Office); *Operations Report, Data as of June 30, 1965* (Washington, D.C., U.S. Government Printing Office); *Overseas Loans and Grants and Assistance from International Organizations, Obligations and Loan Authorizations, July 1, 1945-June 30, 1966* (Washington, D.C., U.S. Government Printing Office); United States, Department of Commerce, *Foreign Credits by the United States Government, Status of Active Foreign Credits of the United States Government and of International Organizations, as of June 30, 1965;* (Washington, D.C.); Export-Import Bank of Washington, *Report to the Congress for the twelve months ended June 30, 1966* (Washington, D.C., U.S. Government Printing Office, 1966).

[a] Includes the following countries and territories: Argentina, Bahamas, Bermuda, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, El Salvador, Falkland Islands (Islas Malvinas), Guatemala, Guyana, Haiti, Honduras, Honduras (Br.), Jamaica, Mexico, Netherlands Antilles, Nicaragua, Panama, Peru, Surinam, Trinidad and Tobago, Uruguay, Venezuela, West Indies (British).

[b] Includes the following countries and territories: Afghanistan, Bahrein, Bhutan, Brunei, Burma, Cambodia, Ceylon, China (Taiwan), Hong Kong, India, Indonesia, Iran, Iraq, Israel, Jordan, Kuwait, Laos, Lebanon, Maldive Islands, Malaysia, Muscat and Oman, Nepal, Pakistan, Philippines, Qatar, Republic of Korea, Republic of Viet-Nam, Ryukyu Islands, Saudi Arabia, Singapore, South Arabian Federation, Syria, Thailand, Trucial Oman, Yemen.

[c] Includes the following countries and territories: Algeria, Botswana, Burundi, Cameroon, Central African Republic, Chad, Congo (Brazzaville), Congo (Kinshasa) Dahomey, Ethiopia, Gabon, Gambia, Ghana, Guinea, Ivory Coast, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Morocco, Niger, Nigeria, Portuguese Overseas Provinces, Rwanda, St. Helena, Senegal, Seychelles, Sierra Leone, Somalia, Rhodesia, Sudan, Swaziland, Tanzania, Togo, Tunisia, United Arab Republic, Uganda, Upper Volta.

[d] Comprising the following countries and territories: Cyprus, Gibraltar, Greece, Malta, Spain, Turkey, Yugoslavia.

TABLE A-2

Estimated regional breakdown of the terms and composition of the gross lending for the year 1965[a]

Recipient regions	*Amount ($US billion)*	*Interest (per cent)*	*Maturity (years)*	*Grace Period (years)*	*Share of Total (per cent)*
1. Africa					
(a) Gross official bilateral lending of DAC countries	0.04	—	40	10	5.4
	0.07	1.0	40	10	9.5
	0.08	3.5	25	7	10.8
	0.09	3.5	15	3	12.2
	0.03	4.5	25	5	4.0
	0.05	5.5	12	2	6.8
	0.04	6.5	7	—	5.4
(b) IBRD-IFC	0.08	6.0	22	5	10.8
(c) IDA	0.01	0.8	50	10	1.3
(d) Socialist countries	0.25	2.5	12	4	33.8
Sub-total	*0.74*				*100.0*
2. Asia and Middle East					
(a) Gross official bilateral lending of DAC countries	0.06	—	40	10	3.6
	0.42	1.0	40	10	25.0
	0.04	—	20	7	2.4
	0.04	3.5	18	7	2.4
	0.18	3.5	25	5	10.7
	0.10	4.5	25	5	5.9
	0.06	5.5	22	3	3.6
	0.25	5.5	8	—	14.9
	0.05	6.5	7	—	3.0
(b) IBRD-IFC	0.14	6.0	22	5	8.3
(c) IDA	0.24	0.8	50	10	14.3
(d) Socialist countries	0.10	2.5	12	4	5.9
Sub-total	*1.68*				*100.0*
3. Latin America					
(a) Gross official bilateral lending of DAC countries	0.15	1.0	40	10	13.9
	0.10	3.5	25	7	9.3
	0.07	3.5	15	3	6.5
	0.04	4.5	25	5	3.7
	0.08	4.5	12	3	7.4
	0.06	5.5	12	2	5.6
	0.04	6.5	7	—	3.7
	0.16	5.5	7	1	14.8
(b) IBRD-IFC	0.21	6.0	22	5	19.4
(c) IDA	0.02	0.8	50	10	1.8
(d) IDB	0.15	0.6	14	4	13.9
Sub-total	*1.08*				*100.0*
4. Europe					
(a) Gross Official bilateral lending of DAC countries	0.14	1.0	40	10	30.4
	0.03	3.5	25	7	6.5
	0.06	3.5	15	3	13.0
	0.02	5.5	25	5	4.3
	0.05	5.5	12	2	10.9
	0.05	5.5	7	—	10.9
	0.04	6.5	3	—	8.7
	0.01	7.5	7	—	2.2
(b) IBRD-IFC	0.05	6.0	22	5	10.9
(c) IDA	0.01	0.8	50	10	2.2
Sub-total	*0.46*				*100.0*

Sources: See table A.-1.
[a] Gross lending other than suppliers' credits.

Estimates of terms for the remainder of gross lending for each region are given in table A-2.[e]

5. In the first main set of projections in which the gross inflow of grants and loans is maintained at its 1965 level throughout the projection period, each component of the overall flow to each region was assumed to continue at its 1965 level as given in table A-1, supplemented by the breakdown of gross official bilateral lending of DAC member countries as given in table A-2. In the projection which assumes that the over-all net inflow of grants and loans from 1966 to 1975 is held constant at its 1965 level, the following further assumptions are made with regard to the composition of gross inflows during this projection period:

(*a*) grants are assumed to remain constant at their 1965 level throughout the projection period;

(*b*) suppliers' credits are assumed to increase at an annual rate of 5 per cent;

(*c*) the composition of the rest of gross lending, i.e. total lending other than suppliers' credits, is assumed to be the same as in 1965 and as given in table A-2.

[e] As is shown in table A-1, the DAC figures include a number of countries, overseas territories and provinces which are not included by IBRD in its debt statistics. Since the flow of grants and loans to these additional sources amounted to slightly over $100 million, the DAC and IBRD regional breakdown of countries may, for practical purposes, be regarded as identical once adjustments are made in the IBRD figures to include the United Arab Republic and Libya in Africa rather than in the Middle East.

Annex II *

Developing countries: annual gross inflow required to maintain a given net inflow, 1966-1975[a]
($U.S. billion)

	All regions[b]		
	1966	*1970*	*1975*
1. Gross inflow including suppliers' credits[c]	12.2	14.3	16.4
of which:			
(*a*) Grants	4.1	4.1	4.1
(*b*) Gross lending	8.1	10.2	12.3
of which:			
Suppliers' credits	3.2	3.8	4.9
2. Total debt service	5.1	7.2	9.3
of which:			
On suppliers' credits	—	2.9	5.1
3. Net inflow	7.1	7.1	7.1
of which:			
Suppliers' credits	3.2	0.9	−0.2
4. Net lending	3.0	3.0	3.0
5. Debt outstanding	32.6	52.6	80.7

Sources: See table 1 in the text.

* This table provides projections undertaken on the basis of aggregate figures for developing countries as a whole. A comparison of this table with table 2 in the text, therefore illustrates the effects of disaggregation to the regional level undertaken in that table.

[a] Minus sign indicates excess of repayments over new inflow.

[b] Includes all countries given in table 1 in the text.

[c] Inflows, debt service and debt outstanding are defined as in table 1 in the text. Grants are assumed to grow at an annual rate of 5 per cent for each region. The remainder of gross lending is assumed to take place in the following proportions: official bilateral lending of DAC member countries 68 per cent; lending from multilateral organizations 23 per cent; lending from the socialist countries of Eastern Europe and Asia 9 per cent. The following weighted average terms are applied to each source of gross lending:

Officially guaranteed suppliers' credits: 6 per cent interest, one-year grace period, six years maturity;

Unguaranteed suppliers' credits: 8 per cent interest, no grace period, two years maturity;

Official bilateral lending by DAC countries: 3.5 per cent interest, six years grace period, twenty years maturity;

Loans from the socialist economies: 2.5 per cent interest, four-year grace period, twelve years maturity;

Loans from multilateral sources: 3.6 per cent interest, seven-year grace period, thirty-five years maturity.

DOCUMENT TD/7/SUPP.4 *

The tying of aid — by Jagdish N. Bhagwati **

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CONTENTS

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Chapter I

Introduction and summary

1. Aid may be tied by source or end-use (via specification of commodities or projects). Whereas, however, recent years have witnessed some relaxation in areas such as the project-tying of aid, so that countries like India, Pakistan and Turkey have qualified for increased amounts of aid for non-project, " maintenance " imports, the trend with respect to tying by source has developed towards comprehensive tying, both in surplus and deficit aid-giving countries. The problems raised by such source-tying of aid have thus become urgent. This urgency is reflected in the resolutions adopted by various organs of the United Nations Conference on Trade and Development and subsequent demands for a continuing study of the problems and possible solutions urged on the UNCTAD secretariat and other international organizations such as the Organisation for Economic Cooperation and Development (OECD) (annex I).

2. This paper, therefore, considers the question of source-tying at length. It examines, in particular, the following aspects of the problem: *(a)* the methods by which aid is tied by source; *(b)* the trend towards increased tying of aid by source; *(c)* the reasons for tying aid by source; *(d)* the cost of source-tying to recipient countries; *(e)* the gains to aid-giving countries from source-tying; and *(f)* methods for reducing the real cost of aid tying by source; and proposals for untying aid. The major conclusions of the paper are summarized below.

* Incorporating document TD/7/Supp.4/Corr.1.

** This study by Dr. Jagdish N. Bhagwati, Professor of Economics, Massachusetts Institute of Technology, was prepared at the request of the UNCTAD secretariat. The views expressed in the study do not necessarily reflect those of the UNCTAD secretariat.

3. Tying aid by source includes all practices aimed at restricting the recipient country's freedom to apply the aid to import from sources other than the aid source. Formal restrictions are the clearest and most important form of tying, but informal and indirect restrictions may also be applied effectively. Aid can also be tied directly, as in the cases of aid in kind, of technical assistance expenditures and of export credits, which constitute a significant proportion of total aid flows.

4. Recent years have witnessed a steady and marked growth in aid-tying practices, so much so that some major aid-giving countries now regard procurement restrictions as the rule and untied aid as the exception. This trend has arisen from a complex set of motives, dominant among which has been the desire of aid-giving countries to improve their balance-of-payments position. At the same time, aid-tying practices have by no means been limited to donor countries with balance-of-payments deficits, since surplus countries, partly as a reaction, have increasingly adopted procurement restrictions. Other major reasons for the trend toward increased aid-tying have included internal pressures by commercial interests in such countries to gain export orders and a widespread desire of these countries to be associated with the construction of specific projects rather than simply with their financing. It is clear, in any case, that a strong competitive element is present in aid-tying and that a tightening of restrictions by a donor country is likely to generate tighter restrictions by other donor countries.

5. In estimating the costs of tying to the recipient countries, a distinction should be made between the costs which could be avoided by a full use of availabilities for switching imports form one source to another, and the unavoidable costs. It is shown below that if aid is tied by source alone, switching possibilities are greater and the costs of tying to the recipient country correspondingly smaller, and that if aid is tied by project as well as by source the costs of tying are likely to be much more significant. Other things being equal, switching possibilities will be greater in relation to the availability of free foreign exchange and the freedom to diversify the sources of aid. It should be emphasized, however, that the switching possibilities open to recipient countries are in any case severely limited. The sequential nature of given aid flows prevent the utilization of simultaneous international tendering, which is essential if advantage is to be taken of switching possibilities in the context of a development plan. Also, because of the high geographic concentration of the aid of each major donor country and the limited availability of free foreign exchange, genuine international tendering is often restricted in practice by the fact that potential suppliers from sources other than the aid source are aware of the recipient country's dependence on the source of aid, and consequently of their lessened chances of obtaining a particular contract.

6. The direct costs of tying aid can be estimated as the difference between the cost of importing from the tied source and the cost of importing the same commodities from the cheapest source. It is important to note that excess freight charges can add significantly to tying costs, and that price differences are in many cases likely to be considerably enhanced by monopolistic pricing by suppliers in the donor country, who are aware of the limited flexibility allowed the recipient country in choosing the source of supply of its import.

7. In addition to the direct costs incurred, tying of aid has significant indirect costs for the recipient country. These may include higher costs for maintenance or repairs, more expensive spare parts or inputs, delays frequently associated with securing appropriate items from the tied source, and distortion of development priorities.

8. An analysis of the limited general evidence available points to the conclusion that the direct costs alone of aid-tying are equivalent to a significant proportion of the value of the tied aid, and almost certainly account, on the average, for as much as one fifth of the value of tied aid. In specific cases, price differentials amounting to 100 per cent or more are not uncommon.

9. It is also shown below that the balance-of-payments gains obtained by the donor country from tying are considerably smaller than the value of the tied aid. Examination of existing studies shows that direct gains are probably in the vicinity of 40-50 per cent of the amount of tied aid. If all relevant secondary and indirect elements are introduced into the estimates, the balance-of-payments gain for the donor country corresponds to only about one third of the value of the tied aid.

10. Due to the competitive element in aid-tying, a realistic process of aid-untying would have to be gradual and simultaneous for all donor countries, and should allow countries with balance-of-payments deficits to untie a smaller proportion of their aid at each stage than surplus countries. Other proposals for reducing the costs of tying to the recipient countries include: *(a)* treating the excess costs of tied aid to the recipient countries as an export subsidy rather than as aid; *(b)* granting waivers for imports from developing countries; *(c)* avoiding the tying of aid by both source and project, as this form of tying can lead to serious monopolistic exploitation; *(d)* encouraging to the greatest possible extent competitive international tendering on aid-financed projects; and *(e)* acceptance of debt-service payments in the products or currencies of debtor countries. Developing countries could also reduce the real cost of tied aid by pursuing optimal procurement policies and also by a flexible operation of import controls by permitting diversification (by source of imports) among different licence-holders.

Chapter II

Methods by which aid is tied by source

11. Tying aid by source must be defined to include all practices by which the recipient country's effective choice to spend the aid on imports from alternative sources, other than the tied source or sources, is sought to proscribed.

12. Note that our definition would permit aid to be described as source-tied even though, by exploiting switching possibilities (as discussed later), the recipient effectively "unties" part or all of the aid. At the same

time, it would not exclude practices such as simultaneous project-tying, with projects selectively chosen so as to yield the donor country advantages in competitively tendering for them. That some methods of tying could, *ceteris paribus,* cause less real cost to be imposed on the recipient countries, by comparison with other methods, is a separate issue which is examined intensively later.

13. In general, tying by source can be divided into five major types: *(a)* formal restrictions; *(b)* informal restrictions; *(c)* indirect restrictions; *(d)* export and import credits; *(e)* aid directly in the form of goods and technical services.

Formal restrictions

14. The most direct form of tying is to require formally and contractually that the recipient country spends the aid funds for importing goods and services only from the designated source or sources.

15. In order to implement such tying, clearly the aid must be disbursed in such a way as to give rise to "directly identifiable" imports, whose source or origin can be ascertained to ensure that the formal restrictions on procurement by source are not violated.

16. In these cases, the disbursement procedures vary with countries, depending also on whether the recipient country operates an exchange-control system. In the case of United States aid expenditures, which are formally tied, for example, procurement authorizations are requested from the recipient country and are submitted through the local missions of the United States Agency for International Development (USAID) for approval in Washington.

17. Where, however, the aid expenditure does not lead to identifiable, direct imports, it has always been difficult to tie aid by source. This happens typically with the "local cost" component of project aid, as also with the more common "budgetary grants" which have been made by donors such as the United Kingdom to recipient governments. Even in these cases, however, some donor countries have begun to devise formal restrictions. These usually take the form of "restricted accounts" arrangements under which the recipient country is required to spend the aid received on a specified source or sources. The United States has, in particular, resorted to such devices. These arrangements have also been used by the United States to ensure that, although recipient countries are permitted to use aid funds for procurement in eight designated developing countries (see para. 30 below), the receipts from such procurement are eventually spent (by these eight countries) on United States goods and services.

18. It is difficult to quantify the importance of such formal tying of aid in relation to total aid flows, as the relevant data are not generally released. However, it has been estimated that during the years 1961-1963 about two-thirds of gross bilateral assistance by countries members of the Development Assistance Committee (DAC) of OECD was contractually tied or otherwise limited.[1] The proportion subject to tying has, moreover, increased since the year 1963.

19. In this connexion, it is also relevant to note that some donor countries have sought to impose formal restrictions on shipping to be used for freighting aid-financed imports. However, with the exception of the United States and Japan, all DAC donors have refrained from imposing such restrictions. In the case of the United States, however, legislation under Public Law 83-664 prevents the utilization of aid for financing transportation of aid-financed goods in vessels which do not have United States registry. Further, at least one-half of the aid-financed goods are required by legislation to be shipped in United States bottoms. Similar restrictions have been applicable to goods financed by Export-Import Bank of Washington (Eximbank) credits, to which we shall refer later.

Informal restrictions

20. Quite aside from the formal restrictions just described, and the suppliers' credits which are automatically linked to exports from the donor source, as is aid directly embodied in the form of commodities and technical services, it is possible to tie aid by source through "informal" means. It is frequently pointed out by countries such as the United States which tie aid explicitly and formally, that countries such as France manage, despite overt abstention from formal tying, to arrange that recipient countries spend virtually all of their aid in the donor country. Of course, this is not necessarily proof that informal tying exists. It may be due to the competitive position of the donor countries in international markets; or it may be due to the prevalence of traditional trade ties with such countries (which secures for the donor an advantage in competing with alternative suppliers); or it may again be due to the influence that the donor country may have in the recipient country through cultural and traditional ties, reinforced by the presence of ex-colonial personnel in the local purchasing agencies and civil service generally (which seems to be partly relevant to the aid expenditures of French-speaking African countries).

21. On the other hand, there is little doubt that informal tying operates with efficiency in many cases. This can take the form of impressing on the recipient country that any departure from *de facto* tying in purchases would be short-sighted and would cause difficulties in continuing or even granting aid: current United States practices would seem to come fairly close to explicit pursuance of such a policy.

Indirect restrictions

22. However, much the most subtle form in which source restrictions are applied is neither formal nor informal but what might most aptly be described as "indirect". There are essentially two forms in which this is done, at the moment.

23. One method is to treat the aid flow as part of an over-all trade arrangement, as is done by the socialist

[1] OECD, *Development Assistance Efforts and Policies, 1965 Review* (Paris, 1965), p. 90.

countries. An alternative method, practised by the French authorities, is to couple the aid flow with provisions under which the aid is to be spent on French goods and services while France " reciprocally " purchases from the former French-African territories on a preferential basis. In fact, the entire Franc Zone arrangements, with their monetary and trading implications, are generally recognized as making the question of informal or formal tying somewhat academic. It is interesting to note, in addition, that France has nevertheless resorted to formal tying restrictions in cases where these *de facto* tying arrangements were considered to be inadequate.[2]

24. Another method, which seems to have gained ground whenever formal and informal restrictions have been considered undiplomatic, is to finance only those commodities or projects where the donor country is considered to have a decided advantage in tendering or supplying the specified items. This policy, widely believed to be now practised by the Federal Republic of Germany (and we shall have more to say about this later), can be implemented by letting it be known generally and informally that the chance of securing aid would improve if the project or commodities required were " suitably chosen " so as to result in directly identifiable imports from the donor country despite competitive tendering.[3]

25. Variations of the preceding policy may also be mentioned. Thus, a donor country wishing to avoid formal and informal tying may reduce the amount of " local cost " financing or purely budgetary-support grants that it will make. Also, it may deliberately direct projects towards using materials imported from the donor country even though they could have been devised to use cheaper domestic materials that would have necessitated " local cost " financing.

Export and import credits

26. Further, there are credits extended to importers or exporters, which are automatically linked therefore to exports from the lending countries. There are essentially two main types of credit to be distinguished here :

(a) On the one hand, there are the so-called suppliers' credits. These are private export credits, guaranteed partly or wholly by institutions whose financial support for such activities is directly or indirectly to be traced to official policy. These credits have now reached large proportions (see table I) and can be obtained from practically all donor countries.[4] These credits can, however, hardly be described as " international aid ", for they are clearly advanced by private exporters whose aim is principally to become established in international markets. The fact that governments, directly and indirectly, help to underwrite, guarantee and promote such credits would seem to make little difference to the fact that they are essentially the result of private initiative, much as private investments are. In fact, they represent merely a means by which the effective export prices of capital goods are cut : it is possible to take these credits and discount them back to a current value such that the effective reduction in export price that they make possible can be readily calculated. From this point of view, the efforts at getting the grant of credits co-ordinated by the " lending " countries, and arriving at rules under which the grant of such credits, and their terms, would be regulated by agreement, would merely represent a form of collusive action by the exporting countries which would artificially inhibit the otherwise *de facto* cutting of their export prices.

TABLE 1

Flow to developing countries of guaranteed private export credits net[a], 1960-1965

($U.S. million)

Year	*Over 1 up to 5 years*	*Over 5 years*	*Total credits*
1960	370	93	463
1961	272	221	493
1962	236	399	635
1963	259	293	552
1964	348	533	881
1965	286	455	741

Source: IBRD, *Suppliers' Credits from Industrialized to Developing Countries*: A Study by the Staff of the World Bank (Washington D.C. 1967).

[a] The figures on export credits are annual net increases in outstanding amounts of guaranteed export credits, including the non-guaranteed part of these credits. The IBRD report, *Suppliers' Credits from Industrialized to Developing Countries*, explicitly points to the unreliability of the information leading to these figures and suggests that they be trated as indicative only.

(b) Of relevance in discussions of tied aid, therefore, are only public sector exporter and importer credits, such as the sums directly given to purchasers in the importing country on a long-term basis by the Eximbank of the United States, or the credit extended by the Government of Canada, through Canadian exporters, on the basis of specific contracts for the supply of equipment, or the official export credits granted by Italy through the Mediocredito, or the Kreditanstalt für Wiederaufbau (KW) long-term finance that is made

[2] Thus, for example, the policy of the Fonds d'aide et de coopération (FAC) has been to tie aid disbursements explicitly via financing conventions signed with local governments : nearly 20 per cent of total French bilateral and multilateral aid was estimated as being informally and formally tied in 1961.

[3] This need not necessarily imply distortion of choice towards inappropriate or " low priority " projects in cases where the donor country has taken care to see that the projects are suited to the recipient country and has been able to locate a sufficient number of such projects to exhaust the aid commitment planned and requested. However, regardless of how wasteful such an " indirect " system of ensuring *de facto* tying of aid may be, that it can successfully be used to tie aid is undoubtedly a fact to be reckoned with.

[4] An account of the manner in which these credits are guaranteed in different lending countries, and the role of the governments concerned is given in International Bank for Reconstruction and Development (IBRD), *Suppliers' Credits from Industrialized to Developing Countries : A Study by the Staff of the World Bank* (Washington, D.C., 1967), pp. 6-7.

available to foreign importers who have placed orders for goods in the Federal Republic of Germany.[5]

Aid directly embodied in goods and technical services

27. Finally, of relevance to aid-tying by source are the flows which are directly embodied in the form of goods and technical services. The sums involved in such transfers are quite substantial, amounting on the average during 1963-1965 to approximately 38 per cent of the total bilateral net aid flow (see table 2). As is indicated further by table 2, the aid in kind is almost wholly from the United States, consisting again primarily of shipments under the Public Law 480 programme. Aside from the United States, Canada is also an occasional supplier of food aid.

Chapter III

The trend towards increased tying of aid by source

28. While it is not meaningful to quantify the growth in the prevalence of source-tying, at least partly because data and qualitative information on this subject are closely guarded from scrutiny, there is no doubt that the past few years have witnessed a steady departure from the practice of giving untied aid. This has happened not merely in the countries with deficits in their balance of payments but also in surplus countries such as the Federal Republic of Germany, for reasons which are intersting to discuss.

Deficit countries

(a) *The United States*

29. The deficit countries have undoubtedly been the pioneers in this trend. The experience of the United States in this respect is both instructive and not without parallel in other countries such as the United Kingdom.

30. The United States has been steadily tightening its measures in the matter of source-tying. Beginning from 1959, when development loans began to be tied to the United States, all USAID loans have been formally tied and cannot be spent on alternative sources unless inter-agency committees and the USAID Administrator grant waivers. In the matter of grant financing, the trend has been parallel: since 1960, procurement under grants has been restricted to the United States and less-developed countries (in the "free world"), excluding therefore the developed countries of Western Europe and Japan. In March 1966, however, the restrictions were increased and procurement was restricted to the United States and only eight among the less-developed countries: China (Taiwan), India, Morocco, Pakistan, Philippines, Republic of Korea, Singapore and Thailand where, again, payments for procurement were to be tied to the United States through special letter of credit arrangements. Taking, therefore, this indirect tying into account, it is correct to argue that all United States grants have also now become virtually 100 per cent tied to the United States.

31. Even in the matter of "local cost financing", there has been steady tightening in this respect. Wherever the accumulated local currency balances are inadequate for the purpose, and project-financing entails local cost financing, the United States has generally moved in the direction of imposing special letter of credit arrangements which permit payments only for purchases originating in the United States. Up till now, contributions to international organizations have been free of tying. But the latest moves towards tying at least a proportion of the United States contribution to the International Development Association (IDA), are indicative of a rapid transition to a full, 100 per cent tying of all United States aid in the near future. Of relevance in this connexion also is the recent report[6] that the Inter-American Development Bank (IDB) is under pressure, from the United States, to limit the use of IDB ordinary capital outside its member countries.

[5] It is legitimate to ask whether even these official credits are, after all, not attempts to support export levels and improve export performance, exactly as private export credits (guaranteed or not) are, and whether it is not correct to regard the flows of funds implicit in such credits as ways in which effective export prices of exports from the "lending" countries are reduced in order to compete for markets abroad. By the same token, it is not meaningful to expect that untying aid of this kind is feasible for it would undermine the very basis of such credits from the lending countries. This point will be taken up in greater detail later.

[6] See *The Times*, London, 8 May 1967, p. 22.

TABLE 2

Flow of technical assistance and aid in kind to developing countries, 1963-1965

($U.S. million)

Year	*Total official bilateral Net*	*Technical assistance*	*Technical percentage of total*	*Aid in kind*[a]	*Aid in kind as percentage of total*	*United States aid in kind*
1963 . . .	5,712.3	858.4	15.05	1,305.2	22.89	1,303.0
1964 . . .	5,440.8	949.6	17.45	1,284.6	23.61	1,282.0
1965 . . .	5,773.1	1,048.0	18.15	940.3	16.29	940.1

Source: OECD, *Development Assistance Efforts and Policies, 1966 Review* (Paris, 1966), Statistical annex, tables 5-7.
[a] This overstates slightly the amount of shipments in kind because the figures represent the sum of two items: "Loans repayable in recipients' currencies" and "Transfer of resources through sale for recipients' currencies".

32. At the same time, " informal " tying has increased, in the sense of USAID missions seeking to encourage imports from the United States by emphasizing the urgency of the matter to the recipient countries and urging on them the prudence of spending on United States sources even when formal tying is not imposed. Several Latin American countries have thus recently agreed to impose voluntary restraints in their purchases so as to secure them from the United States. Further, commodities of which the United States is a net importer have generally been ruled out from United States aid financing since 1963. Measures to secure full " additionality ", so as to eliminate the possibility of substitution by " commercial " imports are being actively studied. In some cases, USAID has already successfully imposed limitations on financing projects or commodities (via lists) where United States exports would be competitive on commercial terms, thus making it more likely that " additionality " would follow from aid-tying. Sometimes, loans have been made only in respect of imports " in excess of normal marketings " of specified commodities.[7]

33. As a result of these restrictions and actions, the proportion of USAID expenditure devoted to offshore purchases has fallen off drastically. The proportion of USAID commodity expenditures resulting in offshore purchases has now been reduced to close to 10 per cent; the proportion of offshore purchases to total USAID expenditures (including cash flows and non-commodity expenditures) was reduced to 22.9 per cent for the fiscal year 1966 and is expected to be halved within the next two years.

(b) *The United Kingdom*

34. Until 1962, the United Kingdom had been formally tying only loans provided to countries under section 3 of the Export Guarantees Act: these loans represented only about one fifth of total disbursements (net of amortization and repayments) by the United Kingdom during this period.[8] A considerable portion of remaining disbursements (not including technical assistance) consisted of financial contributions for budgetary support and " local financing ", which did not in any case give rise to directly identifiable imports in general.

35. Since then, however, the United Kingdom has generally been tightening terms with respect to tying, under balance of payments pressures. Since 1963 the United Kingdom has tried to ensure, by administrative procedures, that where imports were directly identifiable, these would be procured from the United Kingdom in general. Thus, with respect to " colonial development and welfare grants ", in case of new schemes including grants or loans of £25,000 or more, and in case of smaller schemes consisting wholly or largely of imports of capital equipment, direct expenditure on imports from non-United Kingdom sources now requires reference to the Colonial Office which is to sanction such imports only when it is satisfied that the United Kingdom cannot supply the requirements on " reasonably competitive terms ". The United Kingdom Government has further instituted procedures to examine in respect of all Exchequer loans whether British suppliers could not secure a high share of the imports generated by such loans in the recipient countries, the objective being again to secure orders for the United Kingdom except when the British sources are revealed by consultation to be unreasonably expensive.

36. Thus, an increasing proportion of United Kingdom aid expenditures has come to be source-tied as a result of these methods. The matching of aid flows to existing excess capacity in the United Kingdom, thus amounting to tying by selection of projects to be encouraged in the recipient countries, has also been broached in public discussions of aid policy and seems to have played a certain role in United Kingdom aid policy.[9]

Surplus Countries

Federal Republic of Germany

37. The trend in the surplus countries has unfortunately been, even though haltingly, in the same direction as outlined above, and the reasons for this highlight the complexity of the question of getting or keeping aid untied. The experience of the Federal Republic of Germany, which seems to have attempted to play an enlightened role in this respect at the official level, is quite revealing and hence is recorded here at some length.[10]

38. From the point of view of formal tying, the Federal Republic of Germany had initially been careful not to tie aid significantly beyond that provided through the credits given by the KW out of its own funds, which correspond to the Eximbank credits from the United States. The only exceptions had been the indemnification payments to Israel and some loans provided through the budget. In 1962, as a result of this policy, only 9 per cent of the Federal Republic's capital assistance commitments were formally tied.

39. This was a reflection of the fact that the Money and Credit Section of the Ministry of Economics had held to the argument that the then satisfactory balance of payments situation required that aid from the Federal Republic of Germany be kept untied by source. And yet in 1963 the Federal Government found it advisable to retreat, even though no balance of payments difficulties had occurred or were likely to occur, and formal tying of procurement was applied to 55 per cent of new commitments, whereas (with 3 per cent consisting of

[7] The significant increase in the proportion of Public Law 480 shipments to the total United States aid flow during the period after 1958/1959 should also be taken into account.

[8] Details of tying in 1963 are given in Andrzej Krassowski, " Aid and the British Balance of Payments," *Moorgate and Wall Street Review* (Hill, Samuel and Co. Ltd., and Harriman, Ripley and Co. Inc., Spring 1965).

[9] This was specifically discussed, for example, by the Strachey Mission to India some years ago and seems also to underlie the present indications of British willingness to finance the expansion of Durgapur Steelworks in India when there is excess capacity in the steel-plant-making industry in Britain.

[10] The account given here draws on John White, *German Aid: a survey of the sources, policy and structure of German aid* (London, The Overseas Development Institute Ltd., 1965), pp. 111-116.

offers of consolidation credits) only 42 per cent was left formally untied. Under severe pressure from other donors with payments difficulties the Federal Government retreated marginally, but even in the first half of 1964, over one third of the Federal Republic's capital assistance remained contractually tied. In 1965, 55 per cent of the total aid flow was left formally untied (with 13 per cent consisting of renewals of former credits and 14 per cent of KW credits from own funds and only 18 per cent being otherwise formally tied).

40. At the same time, this description understates the effective degree of aid tying by the Federal Republic of Germany. Evidence points to the fact that since 1963, the Government has increasingly sought to finance projects where the Federal Republic of Germany was likely to secure contracts on a competitive basis, thus predisposing the recipients towards acceptance of such projects[11] (even though they may not have been most advantageous to the recipient) and the Federal Government has also been known to boost the import component of projects in preference to " local cost " financing. The refusal, in many cases, to consider for aid-financing projects in cases where tenders by the suppliers in the Federal Republic of Germany could be expected to be uncompetitive has led nearly 85 per cent of the loans disbursed by the KW to be spent on suppliers in the Federal Republic. This result has also been accentuated by yet another policy, namely, an occasional refusal to allow contracts to be submitted to international tender. " Up to the end of 1962, less than half of German capital assistance projects were put up for tender. The others were presumably projects in which a particular firm had had an interest from the start ".[12] While the Federal Government has claimed that it has given up this policy, and admits to only a few exceptions to it while even claiming formally that tenders are to be required especially when the project is source-tied to the Federal Republic of Germany, the " attitude of German representatives in the field tell a different story from the official one " ; and as long as this is so, a prudent recipient government can be expected to treat the capital assistance as effectively tied even though the utilization of an international bidding procedure might have reduced costs.

41. Why then has a surplus country such as the Federal Republic of Germany with a powerful Economics Ministry conscious of the need for keeping aid untied by source, been forced to such methods of aid-tying? The reasons quoted by one source are instructive :

" The principle that German aid should not be currency-tied — that is, tied specifically to the procurement of German goods and services — has been repeatedly criticized by the representatives of German industry. The criticism mounted sharply when the United States took to currency-tying in order to safeguard its balance of payments. Not only did the American decision mean that German exporters lost their share of orders financed from the US Development Loan Fund, which had been considerable, but it also meant, to their far greater chagrin, that they lost a number of established export markets which had previously been independent of aid finance from any country and which were now flooded with American goods purchased with American tied commodity credits. This result was particularly noticeable in Turkey, where German exporters lost the strong position that they had gained in open market competition. "[13]

42. Thus, part of the reason for the strong pressure in favour of aid-tying has almost certainly been what might be described as " competitive aid-tying " prompted by commercial interest. This is quite distinct, of course, from the competitive aid-tying that can occur between deficit countries with one country tying aid to divert expenditure from the other country whereas the other ties aid in turn to divert expenditure in the contrary direction.[14]

43. A separate motivation for tying, despite a sound balance of payments position, which the Federal Government has found it difficult to stifle arises from the fact that prestige and political kudos for aid are frequently associated not with the source of finance, but with those who build a project. Cases in which major prestige projects have been financed by the Federal Republic but built by firms from other countries are not common, but they tend to attract much public and press comment when they do occur.[15]

44. Thus, it is clear that even though one would expect a surplus country to take no steps to tie aid, particularly if there were strong opposition to this internationally, there are weighty reasons why it is likely to be forced into such practices. And the experience of the Federal Republic of Germany suggests precisely how the

[11] " In 1963 and 1964, several recipient governments began to notice an increasing tendency on the part of German diplomatic representatives to suggest that aid would probably be forthcoming provided that the recipient put up proposals for such and such a project. In several cases, the suggestions were for projects which had a high priority in the recipient's development planning, but the more obvious common factor was the likelihood that the contract would be awarded to a German firm. Since there was no evidence that the new tendency was the outcome of intensified study of the recipients' economies, it was taken as evidence of an increased determination to promote German interests, not as the outcome of improved project selection machinery." (*Ibid.*, p. 114).

[12] *Ibid.*, p. 115.

[13] *Ibid.*, p. 112.

[14] Occasional statements and writings of ministers and responsible officials testify to this element of competitive aid-tying very clearly. Thus, take the two following examples :

(a) According to *Die Welt*, 17 January 1967, Mr. Wischnewski (the Federal Republic's Minister for Economic Co-operation) assured his countrymen that the principle of tied aid would be observed even more rigorously in the future, so as to secure orders for materials and machines produced in the Federal Republic, particularly in view of the attitude of other countries.

(b) Again Walter Scheel (Minister for Developmental Aid in the former Erhard cabinet) has written that, with regard to the question of source-tying, an international agreement was the ideal solution and that, as long as this was not procured, the Federal Government necessarily had to take into account the attitude of other countries and hence the principle of leaving German aid untied could not be regarded as a " dogma " (*Konturen einer neuen Welt*, Düsseldorf-Vienna, Econ-Verlag, p. 23).

[15] White, *op. cit.*, p. 112.

tying will, in such cases, take indirect but effective forms, with little emphasis on the formal tying provisions which would be difficult to defend internationally.[16]

Chapter IV

Reasons for tying aid by source

45. This leads the discussion directly into the reasons which have been alleged to be, and undoubtedly are, important in the spread of the practices of tying aid by source. The present chapter merely outlines these reasons; their substance will be examined in later sections that deal with the benefits to donor countries from aid-tying and possible solutions to the question.

46. The primary cause of tying by the deficit countries, as is evident from the preceding chapter, remains balance of payments difficulties. This argument has been invoked by both the United States and United Kingdom and undoubtedly is the chief reason for their tying practices. However, it is also an argument invoked by countries currently in surplus. For example, Italy has argued in the recent past that the then balance of payments surplus was merely a prelude to increased import spending in support of planned development, so that aid untying would not be adopted as a general policy at the time. Canada and Japan have also continuously produced this reason in support of their tying practices.

47. In a fundamental sense, the balance of payments ground for tying aid is an argument for avoiding the loss of real income that would follow if the aid transfer did not give rise to a matching demand for imports; for, in such a case, the aid donor would have to adjust its payments accounts by suitable adjustments which would lead to deterioration in the terms of trade, and hence real income, in general. A similar motivation, of reducing the real cost of making a certain financial transfer of resources, also underlies the desire to tie aid to industries where there is excess capacity in the donor country or where there are already surplus stocks (as in the case of Public Law 480 shipments). Aid in kind hitherto was primarily to be explained in terms of this motivation, although the unforeseen deficits in food availabilities in countries such as India in the past two years, and the unprecedented sales and depletions of surplus commodities in the United States seem to have reduced this early motivation for expanding Public Law 480 shipments to complete insignificance.

48. Further, as we have already seen in the case of the Federal Republic of Germany, an important role is played also by commercial pressure groups who wish to benefit from the orders that they think ought to accrue to donor country nationals rather than to third countries. This is clearly an important force to reckon with; and it is clear that an element of competitive aid-tying follows from this pressure, for aid-tying by one country on grounds such as deficit in the balance of payments leads to aid-tying by another country whose exporters find their own markets abroad jeopardized by such policies by other donor countries. This competitive element is among the most difficult aspects of the problem of inducing surplus countries to accept (or rather of inducing them to persuade their electorate and pressure groups to accept) aid-tying by other countries on the grounds that their own balance of payments is currently in a favourable position. This is irrational, of course, as the deficit country, in so far as it gives up effective tying, is likely to be forced to undertake other measures which are equally likely to hurt the international industries of the surplus country; but somehow such "indirect" action is rarely so evocative of a threat as direct action in the form of explicit tying measures.

49. But, while aid is tied competitively by countries for commercial reasons, the same commercial reasons are undoubtedly responsible in certain cases for leading to the grant of aid (in which case it would not make sense to propose that aid should be untied and expect that aid would remain at initial levels). Thus, for example, the Japanese aid flow, which is exclusively tied formally (except for a negligible amount for multilateral agency contributions and occasionally from consolidation credits), is to be attributed, partly at least, to a desire to support Japanese exports of machinery and manufactures to the developing countries. This is, in fact, the motivating force behind the Eximbank's activities. The Eximbank's direct loans, which are repayable in dollars at near commercial rates of interest, are explicitly directed at financing purchases from the United States, the loans being granted in fact when some explicit imports from the United States are being considered.[17] It is also the motivation behind the activities of the KW in the Federal Republic of Germany on the basis of its own funds, and of similar institutions in Canada, France, the United Kingdom and Italy.

50. Finally, the tendency to tie aid is also to be attributed to a combination of reasons, political and economic, which lead to project-tying of aid in the first instance and to source-tying subsequently. Thus, some

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[16] Referring to this conflict between the recognition of an international obligation not to tie aid when there is a surplus in the balance of payments and the need to accommodate domestic pressure for tying, John White has stated cogently that:

"The obvious way of escape from this conflict is simply to avoid making commitments for projects in sectors in which German firms are not competitive, which is the solution that the Federal Government seems consciously to have adopted. The tacit application of this kind of criterion does not necessarily conflict with the recipient's interests, but it clearly limits the range of projects for which German assistance is forthcoming. It therefore puts an onus on the Federal Government to take a far greater initiative in seeking out aid-worthy projects, since the criterion is not one that the recipients can be expected to take into account. So long as the Federal Government maintains a policy of not taking the initiative in seeking project proposals, leaving the recipient to produce projects in conformity with criteria which are in fact not fully stated, there is a continuing danger of an unchecked conflict of interest between German suppliers and the recipients of German aid." (*Ibid.*, p. 114).

[17] These direct loans of the Eximbank are a fairly sizeable part of the United States assistance programme, running at an average of $564 million during 1960-1963, which was about 16 per cent of the total net outflow of aid to the developing countries.

countries (the Federal Republic of Germany among them) are keen to tie aid to projects on the ground that this is most likely, in their experience, to lead to an efficient and quick utilization of aid. At the same time, these donor countries feel that the best way to secure credit for their aid in recipient countries is to finance conspicuous projects which are then identified easily in the public mind with the donor country, whereas this political effect is not secured if the aid is not linked to something less conspicuous and dramatic. Further as pointed out above, it is felt that the credit thus obtained goes in practice to those who actually build the project rather than to those who finance it. Hence the desire to tie aid to both projects and source simultaneously. These political reasons are also accentuated by the fact that, even in the donor countries, few people seem to consider it sensible that orders arising from aid financed at the public expense should go to third parties and " benefit " them instead. These attitudes are particularly important, as we have seen, in the surplus countries and also, because of tying by other countries, extremely difficult to resist.

Chapter V

The cost of tying to recipient countries

51. In estimating the cost of tying aid by source, it is necessary to note that the actual cost of tying that is incurred by the recipient country may not be the irreducible minimum cost of tying, and that there may exist opportunities for *de facto* untying of aid, or otherwise reducing the cost attached to restricted procurement, which have not been exploited by the recipient country in question.

52. In estimating empirically the cost of aid-tying by source, therefore, it is important to distinguish between two different questions :

(a) How much cost would be imposed by the tying of aid itself, if the recipient country were maximizing use of available opportunities to substitute, to invite competition and the like ; and

(b) How much cost is actually to be attributed to the fact that the recipient country does not exploit these opportunities which exist even within the context of source-tied aid.

53. In practice, of course, these two questions are difficult to disentangle, but they are clearly of considerable relevance to any assessment of the implications of aid-tying as also to an examination of what can be done to reduce, if not minimize, the costs of such tying if it must be accepted to some extent.

54. In assessing the latter question, it is again necessary to distinguish between what a recipient country could do in principle and what it can reasonably be expected to do in practice when it is aid-dependent and underdeveloped. For example, clever " programming" aimed at gaining maximum advantages out of substitution possibilities may be somewhat self-defeating if it succeeds in jeopardizing the aid flow itself.

55. Assuming, for the sake of argument, however, that the recipient country will be doing the maximum necessary in order to minimize the cost of source-tying of aid, what can be expected to be the cost resulting from such source-tying ? In dealing with this question analytically, we should distinguish between the case where the aid is also tied by commodity and where it is not.

Case 1 : Aid tied by source alone

56. It is readily seen that source-tying will be unsuccessful in its intent in so far as the recipient country would like to spend on purchases from the tied source, from its total pool of foreign exchange from aid and export earnings, an amount that equals or exceeds the amount that is explicitly source-tied. Thus, for example, assume that $300 million of tied aid from the United States is given to India and that, out of its total pool of foreign exchange, India, after considering the relative competitiveness of various alternative sources of supply, would like to spend $350 million on imports from the United States. In this case, it is clear that no effective tying of United States aid has occurred.

57. The same point may be put a little differently. Suppose that, from the available funds other than the $300 million of United States tied aid, India would have liked to buy $210 million worth of United States goods ; and that, from the $300 million of tied aid, India would in any case like to buy $140 million worth of United States goods. In this case, the effective tied aid of $160 million (300—140) being less than the $210 million which is being purchased (from other funds) from the United States anyway, India could readily *de facto* untie the United States aid by merely switching existing imports. For the case where there is licensed allocation of foreign exchange, as in India, all that would be necessary is to finance the existing imports, up to $160 million, from the tied fund account, and thus release the same sum for imports from any other sources.[18]

58. According to this way of looking at the problem, the total pool of funds available to the country is considered as the sum of two parts : the tied aid from a given source and the remainder. And, clearly, it follows that the condition under which tied aid can be regarded as totally untied *de facto* is that the amount that the recipient country would like to spend out of the tied aid funds on sources other than those designated should equal or be less than the amount that the recipient would

[18] If one is dealing with a recipient country not applying exchange controls, then its Government could achieve this objective merely by merging the tied aid funds into the common pool of funds in the foreign exchange market (and would thus be absolved from undertaking intervention in the form of exchange control, for example, to ensure that the purchases from the United States came up to the required tied aid level). In practice, however, one is almost always dealing with recipient countries with exchange control systems, which facilitates the implementation of aid-tying restrictions at the same time that international organizations, and the donor countries through them, eagerly advise the dropping of exchange controls, and the adoption of what are, effectively, flexible exchange rates which they think are not so good for the donor countries themselves (annex II).

spend, from the funds not tied to these sources, on the designated sources.[19]

59. But such a possibility of substitution, with its attendant untying of aid in effect, will not work fully when the funds which would be spent out of the total pool on a source fall short of the tied aid total therefrom. In this case, there will be left a hard core of tied aid, from one or more sources, which is effectively tied even when all substitution possibilities have been exploited.

60. What is then the cost of this hard core of tied aid which is not merely *de jure* but also *de facto* tied ? One is tempted to think that this cost would be measured by the excess cost of the items that would now have to be imported, up to the value of this hard core tied aid, from the tied aid sources ; and that this cost would be minimized by following a world-wide tender policy, then ticking off all the competitive tenders from each tied source against the tied aid, leaving a set of unassigned hard core tied-aid flows and unsatisfied import requirements which would then be matched by the authorities in such a way as to minimize the whole cost of this operation. It might also be concluded that such a policy would also eliminate all elements of monopolistic pricing of suppliers under tied aid.

61. However, there are some important snags to this argument, which imply that the cost of aid-tying in practice will be considerably higher. We will first consider the case where the source-tied aid must be spent on projects (though not on specific projects) and then the case of non-project aid (which again is not tied to specific commodities).

62. *Project aid.* To begin with, world-wide tendering cannot really be applied in the simultaneous sense just described, even to projects. Of course, the world-wide tendering procedure can be gone through for each project ; but this is not the same thing as doing it simultaneously and then allocating projects to cheapest sources, as assumed above. For one thing, aid rarely comes in this simultaneous sense, but is a continuing process even for countries with donor-country consortia. For another, few countries have their projects oriented for such action and indeed cannot be expected to do so, since total aid prospects are usually unclear and given the limitations also of their technical organizations for this kind of work. Hence, in reality, the costs of tying, even when the donor country does not tie its aid to specific projects, are likely to be considerably greater than indicated above. Moreover, the world-wide tendering on projects, which are then ostensibly assigned to different tied sources according to the successful tenders, will not necessarily yield the maximum number of bids and the widest, most competitive quotations to choose from. If there is a preponderance of tied funds from one source alone, and the free foreign exchange of the recipient country is negligible in comparison, then the suppliers from areas other than the tied-aid sources may not deem it worth while to tender at all. Further, if the suppliers from the preponderant tied-aid source know about this limited flexibility, then their tenders may well reflect this monopoly position. Even when the tied aid extends to more than one source, the suppliers from all the tied sources may follow similar mark-up policies, for they would have an advantage over other third-source suppliers in so far as third-source entry is limited by the recipient country's lack of manœvrability. That such implicit collusion can arise is indisputable ; how far it actually arises is difficult to establish. Clearly, such monopolistic charging will be reduced, to the extent that the recipient country's access to free funds is relatively large in relation to tied funds and the tied funds, in turn, are spread over a large number of sources.

63. *Non-project aid.* Finally, similar difficulties arise over non-project aid as well. However, they arise from the methods by which the exchange control authorities operate import control. These methods, when combined with tied funds, lead in practice to the possibility of monopoly pricing by suppliers from tied aid sources. In principle, exchange control authorities could issue licences authorizing imports from the tied source or sources only and make these and other licences transferable so that licence-holders could themselves exploit all arbitration possibilities so as to minimize losses, leading to the same result in principle as a world-wide tendering procedure (on the assumption that the importers act with similar energy to seek out the lowest-cost sources of supply).

64. However, in practice, many governments in fact specify both items and source (where there is tied aid), as the authorities are keen to ensure that only " priority " uses are permitted. But once both items and source are specified, the donor country specified becomes in effect the only feasible source of supply. The fact that the licensing authorities, in conjunction with the USAID mission for example, have specified (on the licences) only those items where the United States is regarded as a low-cost supplier will then not necessarily mean that the supplies will come at the competitive rates that would be offered in an open market.

65. Where the suppliers of the designated items are few in number, explicit collusion cannot be ruled out — even though the aid missions attempt to examine prices and prevent such practices. But even when the suppliers are " numerous ", the fact that the supply is to be undertaken against aid-finance will often lead to a higher price being charged than if it were to be undertaken in a less restricted market. Thus, for example, United

[19] This condition is, of course, identical with the earlier one when the spending out of the entire pool of funds was considered. Note, however, that whether such possibilities of substitution will be allowed to exist and be exercised is quite a different matter. It is well known that the donor countries increasingly worry about such substitution, when they are in payments difficulties, and have a tendency to impose informal restrictions in this matter, as also to indulge in commodity specification which prevents such substitution by earlier, " commercial " imports. Indeed, since such substitution can occur even among different donors, with their aid funds, it is now increasingly contemplated that the tying should be done by specifying commodities in which the donor has the least advantage : this would mean that the donor would be able to secure all orders that it can, on a competitive basis, from all the foreign exchange resources which the recipient country can put up to tender, and ensure thereby the full " additionality " of tied aid purchases. We shall revert to this later.

States suppliers will treat the aid-financed sales as equivalent to domestic sales and will generally charge f.o.b. prices, for such aid-financed contracts, which are equivalent to domestic prices. But, as is frequently the case, the competitive f.o.b. price charged by many manufacturing concerns is lower than the domestic price — largely because the foreign market is considered to be more "competitive" owing to the presence of foreign suppliers.[20] Thus, the fact that tying of aid leads United States suppliers, in this example, to price abroad as though they were pricing for a domestic sale, thus treating aid-financed sales as a mere extension of domestic market sales, will also result in the recipient country being overcharged, in relation to the competitive f.o.b. price that it would have secured if the tying of aid had been replaced by free flow of funds, for its imports from the tied source. Note that: *(a)* while this need not occur systematically, since some firms may not follow such pricing practices, there is considerable agreement among knowledgeable analysts that there is indeed such a discrepancy between domestic prices and competitive f.o.b. prices in general; and *(b)* discussion by the author of this point with procurement officers in one aid mission revealed that the practice under which a domestic price may be charged to foreign purchasers buying under aid-finance was treated as "legitimate" and, by no means as an exercise of "monopoly power" which, in fact, it is from a strictly economic point of view.

66. As these margins, which are lost under tied aid, may be fairly large (if the evidence that obtains with respect to such practices is indicative), the loss imposed on the recipient countries from the tying of aid may be quite considerable despite the recipient country exploiting the substitution possibilities.

67. The specific problem just discussed arises from a licensing system which specifies imports and source simultaneously in view of *(a)* an aid-tied situation which requires that the imports from the donor source be not allowed to fall below the specified level; as also *(b)* a desire on the part of the recipient country to maintain priority allocation of imports. One way to avoid the problem, however, while maintaining priority uses, would be to permit trade-offs between licensees so that if someone is, for example, in possession of a United States licence for a certain level of imports of item "x" that he does not want, he can trade it off for a certain level of imports of item "x" from the United Kingdom with someone who as given a licence for imports of item "y" from that country. Thus, the exchange would leave the first licensee with the same level of imports of "x", but without being limited to United States sources, and the second licensee with the same level of imports of "y", but without being limited to United Kingdom sources. Such trade-offs would thus preserve the priority pattern of imports and ensure expenditure of aid on tied sources, while ideally establishing conditions of competition which could help to eliminate the kind of exercise of monopoly power which is otherwise conferred on exporters from tied sources.

68. The situation may however not be ideal: the trade-offs may be theoretically possible but the market may not be functioning ideally to make use of the opportunities; moreover, if there were a preponderance of funds tied to one or two sources, there may be effective exercise of monopoly power from these sources as the possible trade-offs would be limited and may not be sufficient to ensure effective competition to eliminate the exercise of monopoly power entirely.

69. Thus, even if optimal policies of procurement were to be followed with respect to both project and non-project imports, so as to exploit substitution possibilities aimed at minimizing the real cost of tied aid, there are sufficient reasons to think that the costs would not be eliminated in practice. Nor can these optimal procurement policies be necessarily followed, for reasons already set out: for example, the sequential character of aid flows which prevents the utilization of simultaneous tendering for different projects. In practice, therefore, the recipient countries would necessarily face the prospect of high cost attached to the hard core of effectively tied aid plus monopolistic prices on a wider range of tied aid flows, even though the aid were assumed to be tied by source and not simultaneously by commodity specification as well.

Case II: Aid tied by specific projects and by commodity

70. In practice, aid is often tied (at the donor country end) by specific projects, as also by commodity when non-project aid is granted. In either case, therefore, the real costs have to be evaluated in terms of a simultaneous tying by source and commodity specification. As will be readily seen, this practice can be used, with varying degrees of effectiveness, to reduce or even eliminate the possibilities of substitution that were outlined in the preceding discussion.

(a) *Aid tied to specific projects*

71. Let us consider first the case of source-tied aid which is also tied to specific projects. The exact costs that are associated with such double-tying will depend critically on the precise method by which the specific projects are chosen.

72. *Method 1.* — If the projects are chosen after a world-wide tender for all projects, then the costs which would obtain will be identical with the costs we have already discussed earlier for the case of aid tied by source alone. Clearly, therefore, we are interested here in methods of project selection which do not follow this procedure.

73. *Method 2.* — An alternative and more realistic procedure is for the recipient country to have a list of projects from which, by mutual consultation, certain projects are assigned to different tied sources on the assumption that these are likely to be the cheaper sources

[20] Evidence on this widely-recognized practice was gathered systematically by Milton Gilbert for the inter-war period. See his study: "A Sample Study of Differences between Domestic and Export Pricing Policy of United States Corporations," which constitutes part I of *Monograph No. 6: Export Prices and Export Cartels (Webb-Pomerene Associations)* in the study *Investigation of Concentration of Economic Power* (Washington, D.C., United States Government Printing Office, 1940), prepared for the United States Temporary National Economic Committee.

and will impose least excess cost from aid-tying. This may appear to be an approximate, rough and ready way of doing what the system of world-wide tendering and allocation to different tied sources later will accomplish.

74. However, this is not the case. There is first the simple fact that the relative cheapness of alternative sources may be wrongly estimated by the parties engaged in the exercise : there is no adequate substitute in general for a tendering system. Further, the monopolistic practices discussed in the preceding subsection will emerge, as soon as a project is allocated in advance to a tied source. In particular, the overpricing resulting from the " extension of the domestic market " variety of argument will persist in this situation.

75. Inviting tenders from suppliers within the designated source will be inefficient as an instrument for eliminating monopolistic overpricing if suppliers can enter into collusion (implicitly or explicitly) more easily and readily when they belong to one source rather than several. It is sometimes sought to refute this argument on the grounds that the tenders invited could be on a world-wide basis. However, this could not help if the project was known to be assigned to one specific source already: there would be no incentive for suppliers from alternative sources to tender in such a case.

76. Needless to say, if the recipient country does not invite tenders even from the suppliers of the designated country, there is every likelihood of the monopolistic pricing being even greater than in the case of explicit monopolistic collusion by suppliers. In fact, there are many cases on record of such overcharging, resulting from the recipient country not having followed a proper tendering procedure even within the feasible limits. It is interesting to note that the reasons for not following even this limited tendering procedure may be several.

(i) Often a foreign firm has been associated with a particular project from the beginning and its getting the order is regarded as practically automatic.

(ii) In some cases the aid actually follows upon a project having been worked out by a specific domestic firm in collaboration with firms or the government in a recipient country, so that tendering is regarded as " academic " and the firm's prices, provided they are not seen to be outrageously exorbitant, are taken on trust as reasonable.

(iii) In a few cases, further, the lack of tendering has been argued to reflect corruption in the recipient country, with the connivance of influential people in the lending country.

77. *Method 3.* — Finally, the method of project selection for a tied source may be neither by reference to simultaneous tendering for different projects nor exclusively by choice prior to the invitation of tenders on the selected project.

78. Several projects, in practice, are " associated " with certain sources which seem to be the likely source of finance, for a variety of reasons, for them. As Mahbub ul Haq indicates in his pioneering analysis of tied aid for Pakistan, the optimal method in such cases is to invite tenders on a world-wide basis and to threaten to shift the project to alternative sources if the " associated " tied source for the project is unduly expensive.[21] Undoubtedly, this method, which is akin to the first method discussed above with the basic difference that projects acquire the likelihood of being assigned to particular sources quite independently of the results of the tenders, is superior to the second method discussed above. However, it would be illusory to think that all monopolistic overpricing, especially the " extension of the domestic market " variety, will disappear in cases where projects are associated with definite sources and therefore can be expected by suppliers from alternative sources to be assigned to these sources.

79. In conclusion, it should be mentioned that we have so far discussed the costs of source-tied aid, when also tied to specific projects, on the assumption that the donor country will permit the choice of projects to be made by the recipient country in conformity with the latter's priorities. But this assumption need not be fulfilled. In fact, we have seen already (in an earlier section) how the project choice itself may be dictated by particular supplier interests from a specific donor country — in which case, the cost of such tied aid may be not merely the costs discussed so far but also that imposed by any possible distortion away from priorities from a developmental point of view (assuming, of course, that the recipient country itself would have exercised such a choice, an assumption which is not as valid as it seems).

80. Similarly, the costs can be still further increased to the recipient country if the donor country seeks to increase effective tying by reducing the " local cost " component of the project by artificially raising the import content which is tied to the donor country source.

81. By such distortion of the choice and design of projects, therefore, the costs of aid-tying may be raised above those which would obtain if the donor country were scrupulous and accommodating about the choice of projects.

(b) *Other aid tied by commodity specification*

82. Similar accentuation of difficulties and the cost of source-tying will occur when aid is also tied by end-use other than via projects.

83. In this case the possibilities of inflated costs of supply of specific items may be reduced by mutual consultation, provided that the donor country is agreeable, so that a process of " substitution " is mutually allowed for. But, even ruling out costs that may accrue from the fact that certain items may not be available from the tied source at all or that the donor country may be interested in supplying specific items of low priority to the recipient (with a view to securing " additionality " or for other reasons), there will be a " monopolistic " rise in prices once the commodity specification has taken place. As we have already argued earlier in this section, the aid price is likely to be identical with the domestic

[21] Mahbub ul Haq, " Tied Credits—A Quantitative Analysis," in John H. Adler and Paul W. Kuznets, eds., *Capital Movements and Economic Development : Proceedings of a Conference held by the International Economic Association* (London-Melbourne-Toronto, Macmillan and Company Ltd, New York, St. Martin's Press Inc., 1967), p. 326.

price and hence greater than the normal world-wide competitive f.o.b. price. The result might even be yet further monopolistic price exploitation although suitable information and procurement policies could help to reduce this.

84. Finally, some remarks may be addressed to the assertion sometimes made by donor countries that when import and export credits are granted, as with Eximbank loans, there is no cost to the *de facto* and automatic tying because (i) the recipient countries first choose the items for import themselves and then seek credit; (ii) the credit is given for projects where the national or suppliers have already managed to secure contracts on an international tender basis. The first argument is not always factually correct, especially for smaller donor countries, in the experience of countries such as India. But even were it correct, it is fallacious because the very fact that the "aid" is available from a certain source if imports are procured from it, is sufficient to result in real costs of the kind discussed earlier for tied aid. Further, the second argument is also untenable; only if all suppliers everywhere had access to the same credit terms (given as aid by one country for its exports alone), would it be correct to argue that there would be no costs from the tying. Otherwise, the fact, for example, that an Italian firm knows that it has access to Italian aid credits will enable it to tender more cheaply than a firm from the Federal Republic of Germany without such access; whereas if the latter firm also had similar access, it might have tendered yet more cheaply and the recipient country would have been as well off as if the aid were not tied.

85. To sum up then, source-tying of aid will generally impose costs, inclusive of "monopolistic" pricing by suppliers, even when ideal procurement policies are followed. Moreover, these costs are likely to be accentuated when the donor countries also specify the end-use, by project or otherwise, of source-tied aid. These costs will vary with (i) the flexibility, in substitution, that the recipient country enjoys through access to more than one source of foreign funds; (ii) the extent to which such exploitation of substitution possibilities is permitted by the donor countries; and (iii) the willingness and ability of the recipient country, via optimal procurement and related policies, to exploit such substitution and competitive possibilities as exists.

86. The preceding discussion would be incomplete, however, if reference were not made to yet other indirect costs that may arise from the restriction on procurement sources that source-tying will, in general, impose in some degree.

(i) There may be recurring costs from having imported capital equipment which needs expensive repairs, spare parts and even (perhaps) more expensive inputs (such as raw materials and fuel) for processing or operation. Where the buyer follows an "atomistic" policy, these disadvantages will not be reflected in the price paid; and therefore these costs must be reckoned as additional to those discussed in the preceding paragraphs.

(ii) Further, as we remarked earlier, in chapter III, the cost of tying could involve not merely a higher f.o.b. price but also additional shipping expenses. Such additional freight may involve costs for extra distance and also higher freight rates (as with United States shipping), where there are restrictive clauses with respect to the shipping to be used.[22] Moreover, as Mahbub ul Haq has pointed out, freight rates which are quoted in tenders not open to suppliers everywhere are typically increased, so that monopolistic raising of freight rates also is not uncommon and needs to be watched when aid is tied (see table 3).

(iii) Finally, it is possible that, as with all allocational systems involving direct control, there could be delays associated with finding appropriate items from the donor country to which the aid is tied. Associated with this is the difficulty in establishing trading and commercial relationships with a new area from which tied aid is beginning to come; this itself could cause inefficiency because of delays and may necessitate an expensive "informational" investment expenditure.

(iv) It is also worth mentioning that the effect of restricting procurement to donor countries may be to prevent developing countries from tendering for projects and competing to supply commodities under non-project aid. The effect would thus be to inhibit the growth of export earnings and also, except where supplies are totally elastic, to impose welfare losses on the developing countries which might otherwise have been successful suppliers for aid-financed imports.

Empirical estimates

87. If we are to examine the cost of source-tying to recipient countries in practice, as revealed by empirical analysis, obviously the estimates can be undertaken only at the recipient country's end, for it is only there that the full scope for substitution (as discussed above), as also the exercise thereof, can be effectively analysed. And it is precisely this kind of detailed analysis for a few individual recipient countries (chosen from the continents of Asia, and Latin America that the UNCTAD secretariat has now organized, largely along the lines of Mahbub ul Haq's pioneering analysis.

88. Short of such detailed analysis, it is interesting to note that (i) the range of bids, from the highest to the lowest, on international tenders can be very large, thus indicating that the excess cost of procurement from a tied source (even leaving out monopolistic elements) may be significant; and (ii) the incremental cost, of a monopolistic variety, where tendering is limited or non-existent, can be very high indeed.

89. A useful source of information on the former point is the spread of bids on IBRD loans and IDA credits. Two sets of samples have become available

[22] This latter problem is applicable only to the United States. The costs involved can be considerable, for it is well known that United States shipowners will charge, for aid-financed shipments, freights up to three times the open market rates quoted by other companies. It should be mentioned, however, that the excess freight on Public Law 480 shipments is covered by the United States authorities rather than by the recipients: though, here too, it qualifies as "aid disbursed" rather than as an "export subsidy" in the budgetary accounts.

TABLE 3

Instances of higher freight charges under tied credits

Procuring agency 1	*Item* 2	*Whether international bids invited* 3	*Lowest quotation from tied source* 4	*Lowest quotation on international bidding* 5	*Percentage difference (4)—(5) ÷ (5)* 6	*Remarks*
Pakistan Western Railway	Freight on 18 locomotives (large)	Yes	$14,500 per locomotive	$6,800 per locomotive (Norway)	113	Higher freight paid
Ditto	Freight on 20 locomotives (small)	Yes	$9,500 per per locomotive	$5,850 per locomotive (Norway)	62	*Ditto*
Ditto	Freight on 22 locomotives (large)	Yes	$14,500 per locomotive	$6,800 per locomotive (Norway)	113	*Ditto*
Ditto	Freight on 22 locomotives (small)	Yes	$9,500 per locomotive	$5,850 per locomotive (Norway)	62	*Ditto*
Ditto	Freight on 30 locomotives (small)	Yes	$8,380 per locomotive	$5,850 per locomotive (Norway)	43	Waiver obtained in favour of non-United States flag ships. Cost met partly by cash and partly by IBRD loan
Pakistan Eastern Railway	Freight on locomotives (medium)	Yes	$11,500 per locomotive	$7,500 per locomotive (Norway)	53	Waiver obtained; costs met from cash

Source: Mahbub ul Haq, *op. cit.*, p. 330.

recently, which cast some light on this question. Before we discuss them, however, it is necessary to point out some of the key limitations, in inferring from them the potential range of excess costs that tying might impose:

(a) Tenders are not easily comparable because of differing clauses, quality differences, different specifications included by different tenderers, etc. Hence, it cannot always be inferred that the spread observed reflects the actual differences in cost of supply that are relevant to our calculations.

(b) Further, while the spread will indicate the possible differences in cost of supply from a tied source, it has important limitations in this respect:

(i) The actual source of supply under tied aid may have even higher cost than the highest tender in the IBRD bids, for the simple reason that this high cost may itself have precluded a bid from this source: to this extent, the spread shown will understate the actual cost of tying that can arise;

(ii) The tying may be to a source which happens to be a lower cost source of supply than the highest in the IBRD bids; to that extent, the spread between highest and lowest bids will overstate the actual cost of tying that will arise.

90. While keeping these qualifications in mind, we note that the sample bids tabulated from IBRD and IDA data in table 4 show that the percentage of potential excess cost, measured as the ratio of the difference between "high bids" and "successful bids" to "successful bids", was on the average 49.3 per cent and that over 31 per cent of the value of contracts awarded (amounting in total to $200.9 million) were characterized by potential excess cost of over 50 per cent, and 62.9 per cent of the value of contracts awarded were characterized by potential excess cost of over 30 per cent.

91. Turning next to the question of the monopolistic pricing associated with tied aid, Mahbub ul Haq has pointed out that tied aid projects in Pakistan were typically subjected to monopolistic pricing:

> "... the quotations offered by the suppliers are often higher if the suppliers know that it is a tied credit and come down considerably once it is made clear that the supplies will be financed against cash or untied credits... One of the amusing examples in the recent experience of Pakistan was that of Atlas Copco type compressors under French credit. The French suppliers offered certain quotations which, when checked against the quotations received from the Pakistani agents for Atlas Copco, were found to be 33 per cent to 47 per cent higher for various items."[23]

What Mahbub ul Haq does not mention, however, is the possibility that *(a)* there could be "monopolistic" pricing, in the sense of the f.o.b. price under tied-aid-financed exports being equal to the domestic price and therefore higher than the competitive f.o.b. price, for a large range of commodities under both project and non-project aid; and *(b)* that, where the substitution possibility is

[23] Mahbub ul Haq, *op. cit.*, pp. 335-336.

TABLE 4

Frequency distribution of the ratios of difference between high bids and successful bids to successful bids on competitive tendering for twenty IBRD loans and three IDA credits, 1960-1966

	Less than 10%	*10-20%*	*20-30%*	*30-40%*	*40-50%*	*50-100%*	*100% and over*	*Total*
Number of contracts	12	8	13	12	9	27	11	92
Percentage of contracts	13.0	8.7	14.1	13.0	9.8	29.4	12.0	100.0
Percentage value of contracts to total value	17.6	5.4	14.1	13.0	18.6	28.0	3.3	100.0

Source: UNCTAD secretariat, based on IBRD and IDA data.

considered limited, even an international tender may be ineffective in getting lowest rates.[24]

92. Among the country studies, which as we have argued are the optimal way of estimating the actual cost of aid-tying by source, Mahbub-ul Haq's original study of Pakistan produced a figure of 14 per cent of excess cost: a loss of $60 million in a total aid flow of $500 million annually. The somewhat " low " figure is attributed to two main factors:

(a) The possibility of substitution, and its growing exploitation, as Pakistan has access to several alternative aid sources as well as free foreign exchange earnings and untied aid;

(b) A relatively low percentage of tied aid.

However, the estimate is fairly rough and likely to be substantially on the low side in view of Mahbub ul Haq's optimism about avoiding all " monopolistic " elements in pricing under tied aid.[25]

93. The UNCTAD country studies promise to throw more quantitative light on this question. Unfortunately, as of the time of writing the present report, these studies are incomplete. However, it is relevant in this connexion to note that, in so far as donor countries tend, for no matter what reason, to divide up the recipient world into areas of aid-dependence on particular, rather than diverse, sources, the result would, *ceteris paribus*, be to reduce the substitution and competitive possibilities that were discussed in this section and thereby to enhance the cost of aid tying by source. It is interesting to observe, in relation to this question, that:

(a) While the United States had in the past tended to reduce the degree of aid concentration, with the aid expenditures in thirteen principal countries declining from an average of 92 per cent of the total in 1954-1957 to an average of 72 per cent during 1960 and 1961,[26] the recent trend seems to be in the reverse direction, culminating in the policy decision to concentrate United States aid expenditures on fifteen countries; and

(b) The examination of aid distribution shows a preponderant dependence by Latin American countries on United States aid, by French-speaking African countries on France, and by Commonwealth countries other than India and Pakistan on the United Kingdom.

94. Finally, it might be mentioned that a rough-and-ready study of possible excess costs was made when the recipients of United States aid were to be required to shift away from offshore purchases, beginning in 1960. It was estimated at the time that if the recipient countries maintained the same commodity pattern of imports but shifted to United States sources of supply, there would be an average increase of over a third in the cost of imports where the United States was more expensive, but that, computed as the average increase on total commodity expenditure, the excess cost would be about one-half of this proportion.

95. The impression left by these different estimates is that the tying of aid by source — ruling altogether out of reckoning aid in commodities and technical services, as also suppliers' credits — imposes, in practice (and not in theory alone), costs that are significant enough to justify attempts at promoting measures for the untying of aid. Prior to considering these measures, however, it would be useful to examine some of the arguments produced by the donor countries in support of tying aid.

Chapter VI

The gains to donor countries from source-tying of aid

96. As we have seen earlier, the most powerful and persistent argument produced in support of source-tying

[24] Mahbub ul Haq may, therefore, be over-optimistic in asserting that: " In the case of Pakistan, the credits advanced by World Bank, IDA, West Germany, U.K. and Canada, generally do not suffer from any serious drawbacks, partly because some of these credits are untied and partly because there are a large number of items that Pakistan can obtain from these countries at the most competitive prices." (*Ibid.*, p. 331.) Even when Canada can supply competitively at $x per unit, under tied aid, its competitive f.o.b. price under untied aid may have been $(x—y).

[25] Moreover, Mahbub ul Haq does not, in his quantitative analysis, seem to attach any significance to factors such as shifts in priority owing to difficulties of procurement from a tied source etc. Further, the method of measuring the cost of aid-tying used by Mahbub ul Haq, and the subsequent UNCTAD studies, may not fully measure the cost in the strict economic sense of the term. (See annex III.)

[26] Lawrence Lynn, Jr., *An Empirical Analysis of U.S. Foreign Economic Aid and the U.S. Balance of Payments, 1954-1963*, Ph.D. thesis submitted to Yale University, 1966, p. 21.

of aid deficit countries is that it prevents a deterioration in their balance of payments. In view of its importance, we shall examine this argument carefully, looking closely at the empirical evidence in support of it.

97. The argument, put in its skeletal form, is that source-tying will divert aid expenditure by recipient countries towards the donor country and thereby reduce the leakage into third-country exports and hence the deterioration in the donor's balance of payments position. There are obvious qualifications to this argument.

(a) More " return " of the aid by way of demand by recipient countries for exports of a donor country will not, in itself, lead to a balance of trade improvement which " finances " the aid outflow. There has to be a matching release of resources from domestic absorption. It should not be presumed, therefore, that effective aid-tying by source will necessarily lead to improvement in the balance of payments of the donor country. In fact, it will not, if the cause of the donor's balance of payments deficit is excess demand for resources : in such a case, the real problem with the aid process is rather that it involves a transfer of resources for which there is excess demand, so that the important questions then are : (i) can the aid outflow be undertaken at all ; and (ii) whether rich countries ought not to seek ways of accommodating this outflow by restraining domestic demand for resources.

(b) Further, even if it were granted that domestic resources were freed to finance the transfer involved as a result of aid-tying by source, the precise impact of such tying is poorly measured by the estimate of the direct spending by the recipient country on the donor's goods and services. Spending on third-country exports will also in turn lead to further, indirect demands for the donor country's exports, so that the net effect of aid-tying on the balance of payments of the donor country will be less than that measured by the primary impact.

(c) Further, the source-tying of aid may (for reasons already examined at length in chapter IV) be frustrated by " switching ", so that the net impact on the primary spending on the donor's exports may be limited ; on the other hand, if monopolistic charges accrue to the donor country's suppliers, the net improvement in the payments position would exceed the amount not switched by approximately the transfer implicit in the excess of the monopoly prices over competitive prices.

(d) Finally, the net effect of aid-tying on the balance of payments position must be adjusted for the fact that much of the tying is " competitive ". The net improvement for the deficit countries therefore will be less than the gross effect, direct and indirect, because their policies will tend to neutralize one another and because the reciprocal tying by the surplus countries will also help to offset any favourable impact effect on the balance of payments.

98. Empirical estimates of the net effects of aid-tying on the balance of payments of the donor countries are thus notoriously difficult to make. If the estimates are to be meaningful, one would have to have, at the minimum, reasonable guesses concerning *(a)* the extent of aid-tying ; *(b)* the " switching " undertaken by the recipient country ; *(c)* the indirect effects, via third-country re-spending, on the donor's exports ; and *(d)* the extent of " competitive ", reciprocal aid-tying by donor countries. Serious analytical attempts at constructing such estimates have been made only in the United States, although purely " guess-work " estimates are available also for the United Kingdom.

United Kingdom

99. In the course of an empirical exercise at estimating the balance of payments " cost " of the United Kingdom foreign aid programme, Andrzej Krassowski[27] has attempted adjustment for the fact that part of the aid is source-tied.

100. Taking tied aid to be solely the net Export Credit Guarantee Department loans (under section 3 of the Export Guarantees Act, 1949), he proceeds to distribute them by destination according to sterling area and the rest, subdividing the sterling area in turn into " Africa ", " Caribbean ", " Asia ", " Middle East " and " Other colonies ". He then assumes that, for the sterling area, the " switching " will be at 30 per cent and elsewhere at 10 per cent, on the sensible presumption that switching is easier when the initial, non-aid-financed trade with the United Kingdom is significant. He further assumes that the switched portion of the tied aid, which is *de facto* untied, will be spent according to the average share of the United Kingdom in imports by the recipient area from industrial countries.

101. The resulting estimate of the trade diversion in favour of the United Kingdom, attributable to source-tying, comes to £20.54 million for 1963, which amounts to over 50 per cent of the amount that is tied, to over 20 per cent of the net bilateral aid flow, and to under 19 per cent of the entire (multilateral plus bilateral) net aid of the United Kingdom (table 5).

102. This estimate, however, is subject to serious limitations on the following counts : *(a)* the " switching " estimates are pure guesses ; *(b)* the average propensities to spend on United Kingdom goods and services may differ from the marginal propensities, especially when import patterns of the recipient countries are changing significantly owing to developmental programmes ; *(c)* no allowance is made for the increment in spending on the exports indirectly by countries in which the aid is spent initially by the recipients ; to this extent, the " gain " from aid-tying is over-estimated ; *(d)* the estimate of aid-tying is admittedly confined to the Export Credit Guarantee Department loans and hence is on the low side ; and *(e)* no adjustment is made for the fact that aid-tying by others may itself be a function of the British aid-tying.[28]

[27] A. Krassowski, *op. cit.*

[28] This last factor, however, is not of great significance in the discussion of United Kingdom aid-tying, in view of the rather limited sums involved. Clearly its significance is paramount for the United States. Moreover, it should be noted that Krassowski has a detailed statistical analysis of the net impact of aid on the United Kingdom balance of payments, allowing for the effects of the aid flows of other donors : United States, Federal Republic of Germany, France and other DAC countries.

TABLE 5

Balance of payments effect of source-tying of aid by the United Kingdom, 1963

Net flow of foreign exchange, 1963

Region	Total aid flow (in millions of pounds sterling)	Average percentage share of United Kingdom in imports from industrial countries	Tied aid flow (in millions of pounds sterling)	Tied aid flow returning ultimately to United Kingdom: Direct (In percentage)	Tied aid flow returning ultimately to United Kingdom: Direct (In millions of pounds sterling)	Tied aid flow returning ultimately to United Kingdom: Switched portion (In millions of pounds sterling)	Tied aid flow returning ultimately to United Kingdom: Total (In millions of pounds sterling)	Amount of tied aid returning to United Kingdom if it were untied (in millions of pounds sterling)	Balance of payments "gains" from aid-tying (in millions of pounds sterling)
1	2	3	4	5	6	7	8	9	10
Sterling Area									
Africa	45.4	45	5.5	70	3.85	0.74	4.59	2.48	2.11
Caribbean	6.6	40							
Asia	25.2	25	26.3	70	18.42	1.97	20.39	6.58	13.81
Middle East	12.6	30							
Other colonies	9.0	30							
All other countries	1.2	10	5.7	90	5.13	0.06	5.19	0.57	4.62
Total bilateral	100.0		37.5				30.17	9.63	20.54
Multilateral	13.4								
TOTAL	113.4		37.5						

Source: Columns 1-8 from Krassowski, *op. cit.*, p. 32. Columns 9—10 calculated.

United States

103. For the United States, however, there are more systematic estimates of the effect of aid-tying. These consist chiefly of two independent sets of studies, by Lawrence Lynn, Jr. and Alan Strout, although earlier the 1963 Brookings Institution study by Walter Salant and associates had produced essentially speculative estimates in the course of predicting the United States balance of payments for 1968.

104. The Lynn and Strout estimates are characterized by two major elements of sophistication: *(a)* the "switching" possibilities are quantified systematically from the available empirical evidence; and *(b)* the indirect demand for United States exports, via third-country respending of aid is examined intensively so as to see how sensitive the resulting estimates are to various assumptions concerning the reserve-accumulating behaviour of groups of countries, particularly Western Europe. The chief limitations of the estimates consist: *(a)* in implicitly treating the tying of aid by other donor countries as autonomous (this assumption makes very little sense for the United States) and *(b)* in not having any reliable estimate of the reserve accumulating behaviour of trading countries.

105. The "switching" effect is variously estimated in these studies. Lynn's procedure was essentially to estimate United States exports to a recipient as a linear function of different categories of foreign exchange (distinguishing Eximbank loans, Public Law 480 and USAID expenditures) and the base-year market share. Using data for forty-three countries for 1958-1960 and 1962-1963, and taking 1961 as the departure point for United States aid-tying, Lynn finds that the coefficients of USAID expenditure on United States exports change significantly. However, when Lynn drops from the 1962-1963 analysis six countries (Bolivia, Ethiopia, India, Pakistan, Sudan and the Republic of Viet-Nam) where the scope for aid-tying (defined as the excess of estimated expenditure on third countries sought from United States tied-aid funds over normal imports from the United States) is large, the results come out with a slightly larger USAID coefficient but the results are closely consistent with the 1958-1960 estimates.

106. Lynn's results thus indicate strongly that the tying of USAID funds has resulted in the diversion of trade to the United States for six major aid recipients. For these six countries, the minimum diversion (assuming that all switching possibilities are exploited) has been estimated by Strout, using Lynn's data, at approximately \$74 million and \$120 million for 1962 and 1963 respectively. These results, however, are fairly large understatements of the total effect of United States aid-tying during this period for the following reasons: *(a)* they are minimum estimates; *(b)* they relate to six countries, and the possibility of some non-switching by the remaining recipients is not altogether ruled out by Lynn's estimates; *(c)* they relate to USAID expenditure essentially, and do not include the trade-diverting effects of the Eximbank loans and Public Law 480 shipments; Lynn's own analysis underlines the importance of this omission, as his results indicate that during the period 1958-1963 the direct expenditure by recipients on United States merchandise exports from United States aid was around 23 per cent for USAID expenditures, 80 per cent for Public Law 480 and 92 per cent for Eximbank loans; thus, the amount of trade diversion attributable to these two sources of aid-tying could well be in the range of \$500-700 million, bringing the total "gain" from aid-tying *in toto* to around \$600-800 million annually.

107. Alan Strout has re-computed the estimates of trade diversion from the tying of USAID expenditures, by using Lynn's regression estimates of United States market shares for 1958-1960 as an alternative set of calculations of United States market shares. He has also made alternative estimates, using similar procedures, for a larger sample of fifty-one countries. These estimates show on the average that tying by USAID did have trade-diversionary effects; and that the magnitude of the trade diversion, for 1964, was (for the fifty-one-country sample) anywhere from \$490 to \$556 million, signifying a proportion of 47-54 per cent of 1964 USAID-financed exports (to these fifty-one countries). It should be noted that the nominal tying of USAID expenditures during the fiscal year 1964 was only 87 per cent and has increased since. Again, if one adds to this the effect of Public Law 480 and Eximbank loan expenditures, the maximum estimate of trade diversion would easily be in the range of \$1 billion. The trade diversionary effect of total United States aid-tying may thus be well in the range of 40 per cent of United States aid expenditures.

108. This conclusion would have to be modified to the extent that the trade diversion reduces in turn the expenditure on United States exports that would otherwise have emerged as a result of re-spending by third countries (from whom the aid-tying has diverted primary aid expenditure). The extent to which this factor will reduce the "gain" to the United States balance of payments from aid-tying will be measured by $\Delta\gamma A (1 - \lambda)$ where:

A = total aid flow;

γ = proportion of the aid flow that the recipient would spend in the donor country in the absence of aid-tying;

$(1 - \gamma) A$ = therefore, the amount of aid "leaking" to third-country exports;

λ = proportion of "leaked" aid that returns to the donor country via re-spending;

$\gamma A + \lambda (1 - \gamma) A$ = the total amount of aid expenditure that would return to donor country in the absence of aid-tying;

$\Delta \lambda$ = the additional proportion of aid that the recipient would spend on donor country exports due to aid-tying;

$(\gamma + \Delta\gamma) A + \lambda (1 - \gamma - \Delta\gamma) A$ = the total amount of aid expenditure that would return to the donor country under aid-tying; and hence

$\Delta\gamma A (1 - \lambda)$ = the amount of additional expenditure on donor country exports attributable to aid-tying.

It ought to be noted that where $\lambda = 1$, there is no net addition to donor country exports from aid-tying, because in this case the rounds of third-country re-spending eliminate the effects of the leakage altogether. This will be the case if we assume the third countries accumulate no reserves (i.e., spend all aid expenditure that they earn).[29] Where, however, this is not so, λ will be less than unity and aid-tying will lead to improvement (in donor country exports) which will vary inversely with λ.

109. Lynn has worked out, for the United States, some ranges of λ which may be used to arrive at very rough orders of magnitude.[30] Taking the matrix of trade relationships for 1958-1961, Lynn estimates the average

[29] However, in table 6, assumption IV (to the effect that third countries do not accumulate reserves) does not yield a value of λ equal to unity because Lynn, on whose work this table is based, did not use a complete world trade matrix but omitted socialist countries and some other unidentifiable categories. This implicitly means assuming 100 per cent reserve accumulation on the part of omitted countries. This qualification applies to all the four estimates of the indirect expenditure on United States exports included in table 6.

[30] The technique of analysis used by Lynn was suggested originally by Richard Cooper and had earlier been applied by W. Whitney Hicks, "Estimating the Foreign Exchange Costs of Untied Aid," *Southern Economic Journal*, vol. XXX, October 1963, and used also in the Brookings Institution study referred to in paragraph 103.

TABLE 6

Alternative estimates of indirect expenditures on United States exports in relation to United States aid

Region of aid expenditure	*Direct expenditure on United States exports (as percentage of United States aid)* [a]	*Direct leakage into other countries' exports (as percentage of United States aid)*	*Indirect expenditure on United States exports on alternative assumptions concerning reserve-accumulating behaviour* [b c]							
			As percentage of aid				*As percentage of direct leakage*			
			I	II	III	IV	I	II	III	IV
Latin America	33.3	66.7	5.6	13.1	16.3	56.3	8.4	19.6	24.8	84.8
Middle East	11.6	88.4	3.8	15.3	20.3	72.6	4.4	17.3	23.1	82.5
Africa	4.4	95.6	2.1	14.0	17.4	85.1	2.2	14.6	18.1	89.1
Asia	10.1	89.9	6.0	23.4	26.6	66.8	6.7	26.0	29.5	74.2

Source: Adapted from Lawrence Lynn, Jr. *op. cit.*, pp. 110-115.

[a] Based on Lynn's regression equations for 1958-1961.

[b] Assumption I: Canada, United Kingdom European Economic Community other Western Europe, Australia, New Zealand, South Africa, and Japan add incremental exchange earnings to their reserves.

Assumption II: EEC and other Western European countries only add increased foreign exchange earnings to their reserves.

Assumption III: Only EEC countries add increased foreign exchange earnings to their reserves.

Assumption IV: No countries add increased foreign exchange earnings to their reserves.

[c] These calculations are not based on a complete world trade matrix, as trade with socialist and some other countries was left out, which implies 100 per cent reserve accumulation by the omitted countries.

shares of different countries and regions in trade, and assumes these also to be the relevant marginal shares. He next takes alternative assumptions about the reserve-accumulating behaviour of different regions and then arrives at four alternative estimates (table 6) of the percentage of " leaked " dollars that would accrue back to the United States, namely λ for aid spent in each of four regions: Latin America, Middle East, Africa and Asia.

110. These are largely illustrative figures. They do, however, underline the sensitivity of λ to the reserve-accumulating assumptions with respect to the west European countries (including EEC). For assumption III, which implies that only the EEC countries add incremental foreign exchange earnings to their reserves, λ ranges from 18.1 per cent for Africa to 29.5 per cent for Asia and around 24 per cent for the Middle East and Latin America. However, for assumption IV which does away with this possibility, the percentage λ goes up to anywhere from 74.2 to 89.1.

111. In considering these estimates of λ in arriving at the net estimates of the effect of United States aid-tying, using the formula $\Delta\gamma A\,(1 - \lambda)$, it is important to remember that they are based on purely illustrative and hypothetical reserve-accumulation behavioural assumptions, as also on average trade shares. However, if we were to assume, as seems plausible at the present time, that assumption III may be closest to reality, the estimate of primary trade diversion of approximately \$1 billion would be reduced by about \$250 million. The net trade diversionary effect of United States aid-tying (at a nominal level of around 85 per cent) may thus be in the range of 30 per cent of United States aid expenditures.[31]

112. But if we consider the reciprocal element in aid-tying, the net " beneficial " effect on the United States balance of payments will be even less. At an approximate estimate that the rest of the aid donors also secure a trade diversionary effect of 30 per cent from their aid-tying, and assuming that measures undertaken by the United States to untie its aid would lead to entire removal of tying by other donor countries, the net effect of United States aid-tying would be further reduced by about \$80 million.[32] This still leaves fairly large orders of magnitude, at around \$650-700 million, as the net gain from aid-tying by the United States.

General observations

113. Similar estimates could no doubt be made for the other donor countries, notably France and the Federal Republic of Germany, but, unfortunately, they are not available. However, from the preceding analysis, three facts of considerable importance emerge forcefully:

(a) Aid-tying by source is undoubtedly a successful policy instrument for diverting aid expenditure to the donor's exports of commodities and services. In so far as there is, therefore, a matching release of domestic resources undertaken by the donor, it is correct to maintain that aid-tying tends to prevent a deterioration in the donor's balance of payments as a result of the aid flow.

(b) The improvement attributable to the aid-tying varies directly with the reserve-accumulating practices of other trading countries. To put it more specifically, the adverse impact of the untying of aid by the United States on its balance of payments would be significantly reduced if it could be assumed that the western European countries were not likely to put incremental foreign exchange earnings into reserves. The relationship of this conclusion to the more general question of expansion of international liquidity is obvious. Clearly, as long as the countries in current surplus will not agree to an expansion of international liquidity, reserve-accumulating practices will continue to be a serious impediment to the untying of aid. It can also be argued that excessive concern with the balance of payments, and hence resort to practices such as aid-tying by source, originate from a situation where the surplus countries jealously guard their surpluses and the deficit countries are thereby effectively prevented from eliminating their deficits. The only solution (at least in the short run) to this situation is increased access to international liquidity by the deficit countries.

(c) Finally, it is clear that the competitive element in aid-tying is quite important and has significant quantitative dimensions. For example, the net effect of aid-tying by each donor country, assuming the aid-tying of each country to be autonomous, may be in the range of 20-30 per cent of its aid flow, as we have seen in the preceding empirical discussion. On the other hand, if we were to assume that all aid-tying by DAC member countries were to cease simultaneously, and (by hypothesis)

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[31] Alan Strout has pointed out to me, in correspondence, that this estimate may be on the low side because Lynn's estimates of the coefficient for Public Law 480 and Eximbank are now believed to be too low. His likely estimate for 1966, at 39 per cent, derived with the use of different higher estimates for Public Law 480 (at .90) and for Eximbank loans, as also a higher $\Delta\gamma$ for USAID (thanks to increasing efficacy of aid-tying) and a higher λ than that resulting from assumption III in the text, is derived as follows:

Parameter	*Public Law 480*	*Eximbank*	*USAID*
γ (same as untied aid)	.23	123	.23
$\Delta\gamma$	(.90—.23) =.67	(1.00—.23) =.77	.60
λ	.40	.40	.40
Hence: $\Delta\gamma\,(1—\lambda)$	.40	.46	.36

The United States gain in 1966 (for commodities only) thus comes to:

USAID (US procurement only): \$1,190 mn. × .36 = \$430 million
Public Law 480 sales: \$1,270 mn. × .40 = \$510 million
Eximbank direct loans (less 7 per cent service costs):
\$400 mn. × (1—.07) × .46 = 170 million
Total = \$1,110 million

This is 39 per cent [= 1110 — (1190 + 1270 + 370)] of total United States procurement. For 1964, the equivalent figure, assuming a value of $\Delta\gamma$ for USAID of .47, would be slightly less than \$1 billion, which exceeds the estimate of \$250 million in the text.

[32] This estimate is based on the difference between columns 10 and 2, and between columns 11 and 3 in table 7 below.

that there were no differentials in the effects of aid-tying between countries all of which may be hypothesized to have a 30 per cent net diversionary effect, and further that the mutual aid-tying would cause no net loss of reserves to the socialist and developing countries but would only cause offsetting gains and losses among the DAC donors, we can work out illustrative but fairly plausible estimates of the amount by which each DAC member country would " gain " or " lose " from such a policy.[33] Six such alternative estimates have been presented in table 7, distinguishing among the United States, United Kingdom, Federal Republic of Germany, France and other DAC member countries. It is clear from these estimates that the net gains from tying to all countries are significantly less than the gross gains unadjusted for the reciprocal element. In particular, the deficit country United Kingdom would gain considerably from simultaneous aid-untying. However, while the " gain " for the United States is also reduced by about one-sixth on all estimates, the fact remains that it would continue to be a major " loser " from simultaneous aid-untying, chiefly because of the preponderance of its position as an aid-giver among the DAC member countries. Thus, the balance of payments deficit of the United States must continue to serve as an important brake on any move towards a simultaneous untying of all aid flows.

Chapter VII

Methods for reducing the real cost of aid-tying by source and proposals for untying aid

114. The preceding analysis has shown that aid-tying can impose fairly large costs on recipient countries and that the available empirical studies underline the actual existence of such costs. This conclusion is further accentuated by empirical analyses that examine the trade diversionary effects of aid-tying: as trade diversion increases, so will the cost of aid-tying to recipients, other things being equal.

115. At the same time, it is necessary to recognize that even simultaneous untying of aid by all donor countries is certain to leave the United States in particular with the problem that a large part of procurements from its aid — about 30-35 per cent — is likely to " leak " into non-United States sources of supply, thus making the task of eliminating its payments deficit correspondingly more difficult (noting again that even trade diversion would not help if domestic absorption is not reduced to permit the elimination of the deficit). Thus, the principal aid-giving country, the United States, is unlikely to be enthusiastic about measures for untying aid altogether.

116. Hence, it is necessary to consider two different varieties of proposals : *(a)* those that relate to the untying of aid, while making due adjustments for the difficulties noted already ; and *(b)* those that are based on the assumption (which is more pessimistic) that aid-tying must continue, and which, therefore, are addressed to the problem of reducing the adverse effects of aid-tying on the recipient countries.

Proposals for untying aid

117. In the former category, the most optimistic and, therefore, the least promising proposal would be that donor countries should forthwith and simultaneously cease to tie all aid by source. As we have already seen, a deficit country with significant aid outflows, such as the United States, is unlikely to agree altogether with such a move.

118. However, the prospect for such a concerted elimination of aid-tying would improve slightly, though not significantly, if international liquidity could be significantly expanded so that the United States reserve position improves and the reserve accumulation from excess of receipts over payments by other countries is eased. An alternative suggestion, following an analogy with trade liberalization, would be to work out some form of payments arrangement to finance any marginal deficits that may, and in fact must, arise for individual donor countries such as the United States on aid account alone. The real problem with such an arrangement for an aid payments union, as recognized by its proponent Vinod Shah,[34] is that it is not possible to identify imports financed by aid as against other imports in so far as recipient countries are in a position to " switch " between free aid earnings in financing any given imports from a donor country. This " arbitrariness " makes some kind of convention, in identifying " truly " aid-financed imports, necessary ; and this, in turn, makes the proposal for a payments union directed merely at financing deficits on aid account difficult to implement. Further, it is inevitable, in the foreseeable future, that the United States with its preponderant aid outflow, will run up continuing deficits within such an aid-account payments union, thus making its continued existence precarious.

119. It is, therefore, more realistic to consider the possibility of a simultaneous and progressive reduction in aid-tying by small but similar amounts by all donor countries.

120. Aside from the merit this would have of concerted action and an explicit recognition of competitiveness in aid-tying, it should also be easier for surplus countries such as the Federal Republic of Germany to be able to convince their public that the remaining aid-tying by deficit countries such as the United States was " justified " because it reflected both the larger aid-flows and the deficit situation.

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[33] The detailed methodology is set out at the bottom of table 7. Estimates were also worked out alternatively on the assumption that the DAC countries could lose reserves, as a group, to non-DAC countries, to see whether this made any difference to the conclusions with respect to effects on individual DAC countries. This was done by simply using world exports instead of DAC exports in the denominator of the formula used in deriving trade shares in table 7 (methodology). The qualitative conclusions, however, with respect to intra-DAC " gains " and " losses " were not affected significantly, except for the United Kingdom which naturally turns out as making far more gain from simultaneous aid-untying under the assumption in the text, and even a minor loss on some estimates derived on the alternative assumption now being considered.

[34] See " Development Assistance Payments Union," *Economia Internazionale* (Genoa, Italy), vol. XXI, No. 2, May 1968.

Table 7

Estimates of net gain or loss to DAC donor countries if all of them were to untie bilateral aid (excluding technical assistance) simultaneously

($U.S. million)

Donor country	*"Gain" from trade diversion at 30% net effect, using DAC net bilateral official aid data for years given*		*Estimates of "gains" from other donor countries' untying of aid, using the average shares in trade for years given* — *1962, using trade diversion estimates of years*		*1963, using trade diversion estimates of years*		*1964, using trade diversion estimates of years*		*Alternative estimates of net "gain" (+) or "loss" (—) if all donor countries were to untie aid simultaneously*					
	1963	*1964*	*1963 Col. 2*	*1964 Col. 3*	*1963 Col. 2*	*1964 Col. 3*	*1963 Col. 2*	*1964 Col. 3*	*Columns 4—2*	*Columns 5—3*	*Columns 6—2*	*Columns 7—3*	*Columns 8—2*	*Columns 9—3*
1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*	*15*
United States	956.70	843.30	158.13	156.12	157.92	155.88	156.89	154.76	−798.57	−687.18	−798.78	−687.42	−799.81	−688.54
United Kingdom	90.63	113.22	237.82	211.37	235.66	209.43	222.80	197.91	+147.19	+ 98.15	+145.03	+ 96.21	+132.17	+ 84.69
France	157.02	140.52	158.11	144.90	160.69	147.25	155.83	142.80	+ 1.09	+ 4.38	+ 3.67	+ 6.73	− 1.19	+ 2.28
Federal Republic of Germany	100.62	98.34	294.21	267.80	298.74	271.95	289.72	263.67	+193.59	+169.46	+198.12	+173.61	+189.10	+165.53
Other DAC Countries . .	127.41	119.10	584.09	532.78	591.93	539.94	607.92	554.45	+456.68	+413.68	+464.52	+420.84	+480.51	+435.35
								Totals	—	—	—	—	—	—

Source: Calculated from total net bilateral aid figures for DAC countries in OECD, *Development Assistance Efforts and Policies, 1964* and *1966 Reviews*, (Paris, 1964 and 1966) and United Nations, *Yearbook of International Trade Statistics, 1964* and *1965* (United Nations publications, Sales Nos.: 66.XVII.6 and 67. XVII.2).

Methodology: The procedure was to calculate first the net bilateral aid flows, net of technical assistance, for 1963 and 1964. Then the proportion of 30% was applied, by hypothesis partly supported by empirical work on the United Kingdom and the United States, uniformly to these aid figures to arrive at estimates of net (direct and indirect) trade diversion brought about by each country's aid-tying, as recorded in columns 2 and 3. Next, the export data for years 1962, 1963 and 1964 were used, successively, to arrive at the proportions in which the trade-diverted aid expenditure, if untied, would be spent on each country's exports. These proportions were calculated, as follows, the case of United Kingdom gains from non-United Kingdom countries untying their aid being illustrated here, and where DE = DAC exports, F = French exports, G = Federal Republic of Germany exports, US = United States exports, UK = United Kingdom exports and ODAC = Belgium + Canada + Netherlands + Portugal + Denmark + Italy + Japan + Norway + Sweden; the table below illustrating the ratios measured for the United Kingdom. For the United Kingdom, for example, the ratio $\frac{\text{UK}}{\text{DE—USA}}$ was taken as the proportion of United States trade diversion, as estimated in columns 2 and 3, which would accrue to the United Kingdom as additional expenditure on United Kingdom exports if United States aid were untied. Thus, using column 2 estimates of United States trade diversion at $956.70 million and the 1962 ratio, the gain to the United Kingdom from the United States untying its aid would amount to $956.70 × 0.181 million. Similarly, for untying on the part of the Federal Republic of Germany, the United Kingdom gain would equal $100.62 × 0.159 million. For all untying by non-United Kingdom countries, the gain would then be the sum of these estimates, equalling $237.82 million in column 4. And so on. This method, of course, represents a simple approximation to the "true" effects. Note that the fact that we have taken DAC exports instead of world exports in the denominator is a simple way of ensuring that all DAC countries taken together do not lose to non-DAC countries; this, in turn, rests on the reasonable assumption that the socialist and developing countries will not accumulate reserves.

Ratios of	*1962*	*1963*	*1964*
$\frac{\text{UK}}{\text{DE — USA}}$	0.181	0.179	0.169
$\frac{\text{UK}}{\text{DE — G}}$	0.159	0.158	0.148
$\frac{\text{UK}}{\text{DE — F}}$	0.146	0.145	0.137
$\frac{\text{UK}}{\text{DE—ODAC}}$	0.202	0.202	0.194

121. On the other hand, on this principle of reduction in aid-tying, surplus countries such as France might ultimately be left with some degree of aid-tying while deficit countries such as the United Kingdom might, in view of their lower aid expenditures, be left with none. It may, therefore, be more appropriate if the large-aid, surplus countries were to agree to reduce their aid-tying in larger proportions than other donors.[35] Needless to say, this would leave open a number of questions (such as the identification of the degree of aid-tying by each donor) which may prove delicate.

Proposals on assumption that aid-tying will continue

122. Short of such proposals for gradual but concerted steps for untying the bulk of current aid flows, there are numerous other measures which are suggested by the analysis in the preceding sections.

123. These measures can, in turn, be subdivided into those which require initiatory and permissive action by the donor countries and those which can be implemented by the recipients on their own initiative.

Action by donor countries

124. Among the simpler, but not unimportant, measures that could be adopted are the following:

(a) Greater facility for recipient countries to "programme" their foreign exchange utilization could be provided. This can be done by adoption of the consortium approach, wherever possible: this enables the recipient country to seek and exploit possibilities of introducing greater competition among aid-financed suppliers, as noted earlier.[36]

(b) At the same time, it would help if the donor countries could avoid joint tying by source and by commodity, which can lead to serious monopolistic exploitation.

(c) Donor countries should further explicitly encourage, even require, competitive tendering on projects—even when the project is left tied by source.

(d) Further, there is need for price vigilance by the donor countries' aid-disbursing agencies.

(e) Moreover, it makes good sense to argue that, since (effective) aid-tying imposes excess cost on recipient countries because the sale of donor country exports (which are uncompetitive) is being forced, the fair thing to do would be to separate out an estimated sum of this excess cost and to show it directly, in the budget of the donor country, as export subsidy rather than as aid. This would have a two-fold advantage: (i) it would bring aid figures closer to their "true" value, a matter of some importance when public opinion has become increasingly critical of budgetary appropriations for aid; and (ii) it would save the recipient country, *ceteris paribus*, interest payments as a proportion of the excess cost so netted out.[37]

125. In addition, the donor countries could be persuaded to consider rather more ambitious measures. Since it is advantageous for recipients to have aid from diversified sources, in securing competitive prices, it would be useful if the donor countries would be agreeable to having multilateral aid flows, through IBRD, United Nations agencies, etc., distributed partly with reference to this criterion, and moreover to having these funds available not primarily for social overheads but more freely so as to make realistic the possibility of a shift to multilateral finance in case tied bilateral sources are charging excessive prices.

126. The donor countries could also explore the possibility of "swaps" under which, for example, French aid to Gabon could be swapped for United States aid to Guatemala, with source-tying equally offset and thus leaving *de jure* tying levels intact for each donor but increasing the competition possibilities in both Gabon (which is otherwise strictly geared to French aid) and Guatemala (which is otherwise dependent overwhelmingly on United States aid).[38]

127. In addition, the donor countries could adopt the practice of specifying developing countries as possible sources of supply for aid-expenditure. This practice, if adopted, could also make over time a significant contribution towards the building-up of export earnings via capital goods exports of developing countries with advanced industrial structures such as Argentina, Brazil, India and Mexico.

128. Finally, as long as the donor countries insist on tying aid outflows, it makes equal sense for the recipients to demand that the repayments be tied as well. This principle is implicit in aid transactions of socialist countries and, as long as outflows are tied, is worth extending to repayments of aid to developed market-economy countries (as is indeed effectively the case with the bulk of the United States sales for local currencies).

Action by recipient countries

129. Aside from these actions which could be undertaken by the donors themselves, the recipient countries could try to reduce the cost of aid-tying by self-help measures.

(a) The most obvious thing to do is to adopt sensible procurement practices, including the invitation of tenders and collection of price information from alternative sources. Tendering is, surprisingly enough, followed in relatively few recipient countries.

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[35] This would seem to make more practical sense than the convention suggested by some economists that surplus countries ought to stop all aid-tying. As long as the reduction in aid-tying is mutual and appears, therefore, to be "fair," the chance of surplus countries being able to carry their public opinion with them is greater.

[36] Such "programming" would go further, as we have argued earlier, if aid came from diversified sources, and may mean little if aid comes only from one source, is tied and is large in relation to free exchange.

[37] This, for example, is the practice with the excess cost incurred for Public Law 480 supplies carried by United States flag vessels under Public Law 480 agreements for sales for foreign currencies (Section 108, Food for Peace Act of 1966).

[38] Such swaps need not pose questions of prestige based on "who builds something" if they are carried out for non-project aid.

(b) The other recommendation which emerges from the analysis in this paper, for recipients with extended import controls, is that flexibility in re-transfers of (commodity-specifying) licences between sources is essential and, when removed, increases significantly the possibility of monopolistic pricing by aid-financed suppliers; and hence licences for import, when they specify source and item, should permit flexibility via legalized swapping of licences between sources (as explained in chapter V). It is necessary to recognize that the recipient's import licensing procedures, by specifying both source and items simultaneously, can themselves create monopoly power for foreign suppliers; and that control over the composition of imports, as also aid-tying requirements by source, can be satisfied, while eliminating this monopoly power, by merely permitting swaps (by source) between different licence-holders.

130. Some of these suggestions are already to be found in the resolutions adopted by international organizations of which both recipients and donors are members (annex I). It is also conceded widely that aid-tying needs corrective action. It seems reasonable, therefore, to expect that some concrete action, along the lines described here, will be feasible in the near future.

ANNEXES

Annex I

EXTRACTS FROM RESOLUTIONS ADOPTED BY THE UNITED NATIONS GENERAL ASSEMBLY, THE UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, AND THE DEVELOPMENT ASSISTANCE COMMITTEE OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The urgency of the problems raised by the tying of aid by source has been noted in several resolutions of the United Nations General Assembly, the United Nations Conference on Trade and Development and the Development Assistance Committee of OECD. The resolutions also suggest ways in which these problems may be solved and the impact of aid-tying minimised.

I. *United Nations Conference on Trade and Development*

Two resolutions of the first session are relevant in this instance.

1. *Recommendation A.IV.1, "Guidelines for international financial co-operation":*[a]

"*The Conference recommends that:*

"1. Financial co-operation provided by industrialized countries, both through bilateral and multilateral programmes of assistance to developing countries, should have the following characteristics:

"...

"*(c)* It should permit, as far as possible, the free use of external resources in the acquisition of goods and services in those markets which offer the best conditions of price, quality and terms, including markets in the recipient and other developing countries, unless otherwise required on balance of payments grounds — although it is recognized that even such grounds do not always justify such a different course;

"...

2. *Recommendation A.IV.4, "Terms of financing":*[b]

"*The Conference*

"*Considering* the difficulties generally experienced in present arrangements and which may arise in aid programmes of government to government transfer of capital through loans, and in the availability of suppliers' credits to developing countries from industrialized countries, owing, *inter alia*, to short periods of repayment, high rates of interest, limitations on tying of credits to specific projects and to purchases from the countries providing the capital,

"*Agreeing* that these stipulations and conditions can produce a serious strain on the balance of payments of developing countries and often cause delay and difficulty in the implementation of projects,

"...

"*Recommends* that donor countries, in framing their policies, should endeavour to meet the following objectives, to secure more meaningful and progressive financial co-operation with developing countries and ensure greater efficiency in aid programmes:

"I. *Repayment of loans*

"1. Some part of repayment of loans may be accepted in national currencies of the debtor countries, either through bilateral or regional arrangements, through payments' unions, credit insurance arrangements or other appropriate measures;

"...

"II. *Utilization of loans*

"5. As far as possible, development loans should not be tied to particular projects and, where this becomes unavoidable, for reasons of over-all managerial and technical assistance or bilateral association in some specific cases, or due to special credit terms or acute balance of payment difficulties in donor countries, necessary care should be taken that loans for infra-structure and social schemes such as education, public health and community development should nonetheless be of a particularly 'soft' nature;

"6. Loans for purchase of capital equipment or non-project assistance, should not ordinarily be tied to purchases in donor countries and, keeping in view the desirability of flexibility to developing countries in the procurement policies, should be available for use in best markets and, particularly, in the markets of recipient and other developing countries. In any case, they should be available for purchases in countries with convertible currencies. Moreover, in all cases of tied loans where the recipient country can show that the required equipment and goods are available at cheaper rates or better terms elsewhere, the Governments should intervene either to bring down prices and regulate conditions of supply or, where this is not feasible, to transfer the funds for other purchases in donor countries at competitive rates or, failing that, to release them for free purchase in the best market from the point of view of the recipient country;

"7. Where development loans are unavoidably tied to projects, regard should be had to the fact that some developing countries are not always able to provide the counterpart local currency requirements for implementation of a project and that a number of projects give rise to additional indirect foreign exchange requirements. In such cases, the loans should

[a] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publications, Sales No.: 64.II.B.11), p. 42.

[b] *Ibid.*, p. 44.

be devised, directly or indirectly, to cover substantially more than the foreign exchange component of the project;

" III. *Removal of restrictions*

" 8. Recipient countries should not be compelled to use the shipping of a lending country for the transportation of goods purchased under loans and aid advanced by that country;

" 9. Recipient countries should not be compelled to insure goods purchased under loans and aid advanced by a donor country with the insurance companies of that country;

" ... "

II. *Development Assistance Committee*

The following excerpts from the Recommendations on financial terms and conditions adopted by the Development Assistance Committee at its 58th session on 22 and 23 July 1965,[c] are relevant.

" D. *Measures Related to Aid Tying*

" 15. The problem of aid tying is in certain cases still a significant one. Some financial assistance and the related flow of goods and services are inevitably tied, i.e. come from the same country, as for example in the case of assistance given in kind or export credits. In addition, balance of payments and domestic political reasons have led to considerable aid tying by regulation and administrative action. This development, however, can bring about cumbersome limitations on the freedom of the recipient to choose freely the most suitable sources of supply on the international market. With regard to bilateral assistance, Member countries should jointly and individually endeavour, unless inhibited by serious balance of payments problems, to reduce progressively the scope of aid tying with a view ultimately to removing procurement restrictions to the maximum extent possible.

" 16. Even within the process of aid tying, some steps might be taken to reduce the adverse effects which may result from procurement restrictions. In particular, it is recommended that Member countries apply some or all of the following measures to the maximum extent possible:

" *(a)* ensure that purchases made with tied aid are nevertheless made on the best possible conditions, either by using procedures which allow free competition between domestic suppliers, by systematic checks on the price and quality of the goods supplied, or by ensuring that the widest possible range of goods and services is made available under tied financial contributions;

" *(b)* grant waivers in such a way as to minimise in particular cases the harmful effects of tying on the recipient country; or establish a waiver system under which a third country supplier would be given a contract if his tender were shown to be more advantageous;

" *(c)* allow sub-contracting in third countries where this is economically advantageous;

" *(d)* allow purchases to be made in other less-developed countries.

" E. *Need for Non-Project Assistance and Local Cost Financing*

" 17. Members recognise that, while acknowledging the advantages of the projects approach, it is necessary to see the needs of the developing country as a whole and, therefore, often to provide aid to meet the cost of imports other than those for particular projects as well as, on occasion, to finance the local costs of development. This wider provision of aid does, however, necessitate closer attention to the development programme and its administration than might otherwise be necessary. This in turn implies the need for closer co-ordination between donors of aid programmes and policies for individual recipient countries.

" F. *Need for Adapting Legislative, Institutional and Budgetary Provisions*

" 18. Members are recommended to seek the legislative, institutional and budgetary provisions required to achieve the above objectives.

" 19. Members recognize that, while each donor country must be free to choose the financial techniques appropriate to its own circumstances, financing development assistance from current budgetary resources will increase flexibility in securing substantial improvements in terms. "

III. *United Nations General Assembly*

The following excerpts from resolution 2170 (XXI) on " Flow of external resources to developing countries ", adopted by the General Assembly at its 1485th plenary meeting on 6 December 1966, are also relevant.

" *The General Assembly*

" *Noting* that the Economic and Social Council at its forty-first session adopted resolution 1183 (XLI) of 5 August 1966 on the flow of external resources to developing countries, which reads as follows:

' *The Economic and Social Council*

' *Recalling* General Assembly resolution 1522 (XV) of 15 December 1960 and 1711 (XVI) of 19 December 1961 and the relevant recommendations contained in annex A.IV of the Final Act of the United Nations Conference on Trade and Development . . . which, *inter alia*, defined the objectives to be reached both as to the volume and as to the terms and conditions of the flow of long-term capital and official donations to developing countries,

' ...

' *Noting further with concern* that in some cases tied aid has had, as practical consequences, the adoption of projects, sometimes unrelated to, or with a much lower priority in, national development plans, and the tying of aid to the procurement of goods from the home markets of developed countries which has often resulted in an inefficient use of resources in recipient countries and in the supply of goods and services at higher than world competitive prices,

' *Considering* that in many cases the tying of loans, by countries supplying the capital, has not been accompanied by the tying of repayments, in full or in part, to purchases from the recipient countries,

' ...

' 3. *Urges* the developed countries, in particular:

' *(b)* To make external resources available to developing countries on easier terms and conditions:

' ...

' (iii) By increasing the proportion of non-project assistance and particularly of assistance for development plans or programmes or for projects related to them, taking into account the need for the maintenance and expansion of existing capacity in recipient countries;

' (iv) By making all possible efforts to move progressively towards the untying of loans with respect to the source of supply, taking into account the essential need for increasing the over-all volume of aid;

' (v) Where loans are tied to the supply of goods and services, by making such goods and services available at competitive world prices;

' (vi) Where loans are tied essentially to particular sources, by making, to the greatest extent feasible, part of the

[c] See OECD, *Development Assistance Efforts and Policies, 1965 Review*, *op. cit.*, Annex B.

loans available for utilization by the recipient countries for the purchase of goods and services from other developing countries or from countries belonging to the same zone as the creditor country ;

'...

'5. *Requests* the Secretary General:

'(*a*) To study the feasibility of setting up, within the United Nations Organization for Industrial Development or any other appropriate United Nations body, an advisory service which could provide information to the developing countries on the sources of supply, the cost and the quality of equipment needed for their development ;'

'...'"

Annex II

Tied aid and multiple exchange rates[a]

1. This annex is devoted to demonstrating how "distortionary" *multiple* exchange rates can follow from the effective tying of aid. This is relevant in so far as the less developed countries are exhorted by donor countries directly, and through the international organizations they influence, to avoid the use of such *multiple* rate policies.

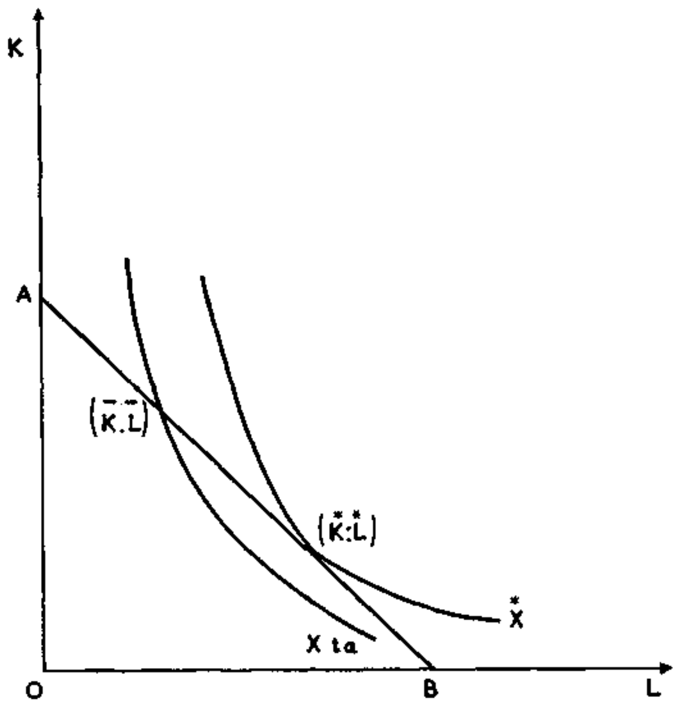
2. A departure from unified exchange rates may be called for as a result of the tying of aid, leading to a constrained maximization of social welfare defined as a function of the currently available flow of goods and services. Note here that this may not call for explicit State intervention ; but it may result in it, in the form of trade or domestic policy instruments.

3. Take, for example, the following two models I and II which are made deliberately simple so as to bring out the essence of the problem.[b] In each case, one designed to show the implications of tying with respect to commodities and the other the implications of tying with respect to source, the possibility of multiple rates arising is demonstrated. The implication is that observed discrepancies between the (best) foreign prices and domestic prices will signify inefficiency with respect to the aid inflow and not with respect to the efficiency of allocation of resources given the constraints on the aid flow utilization. In model III, we shall portray a case where the tying is such as to require actual state intervention to support the required outcome ; this case will correspond to the analysis of situations where bulk trading, for instance, is carried out in a competitive economy at terms which are incompatible with market conditions except via governmental action in the form of tax-cum-subsidies or trade tariffs and subsidies. In this case as well, the implication will be that the official departure from the unified rate policy is a result of constrained maximization imposed by aid conditions ; it will not be that official policies pursued by the recipient country are inefficient.

4. *Model I*: Assume a single product, no exports, imports of two inputs financed by aid, aid tied to specific purchases of the two inputs, and no domestic factors. Let the production function for output be characterized by diminishing returns along isoquants. The international prices of the inputs are fixed.

5. The model can then be illustrated in figure I. K and L are the fixed quantities of inputs obtainable under tied aid ; AB represents the availability line for these inputs, at the given international prices, if aid were not tied. The amount of output produced with tied aid is X as measured at the isoquant passing through (K, L). On the other hand, under untied aid, the optimal solution and equilibrium would be at (K*, L*), where the domestic price ratio would equal the international price ratio. At (K, L), however, the price ratio diverges from the international price ratio, signifying a sub-optimal position, one, however, which a competitive system would reach but which has been caused by the tying of aid rather than by inefficient policies of the recipient country. Multiple rates will thus exist and will signify the inefficiency resulting from the tying of aid.

Figure I



6. *Model II:* Assume the same model as model I except that the aid is now tied to sources rather than to commodities. Let then the supply of input K be cheapest from source I and of input L from source II. The prices are fixed at either source of supply, as before.

7. The model can then be illustrated in figure II. A_2B_2 represents the line of aid availability (in terms of possible combinations of K and L) from source II where L is cheaper ; C_1D_1 the aid availability line from the other source I. The total aid availability line then (in terms of feasible combinations of K and L) will be EFG under aid tying, where EF is parallel to A_2B_2 and FG is parallel to C_1D_1 and $(OA_2 + OC_1) = OE$, and $(OD_1 + OB_2) = OG$. If there were no tying, the possibility curve would be the straight line JFQ. *At F, the two inputs are bought at their cheapest sources.*

8. Under source-tied aid in this model, then, if the maximal isoquant were to touch EF at P, multiple rates would follow because the marginal rate of substitution in production would equal the price ratio in source II and hence diverge from the "best" international price ratio JFQ. Output would be sub-optimal in relation to the level possible under untied aid (at P*) ; the entire aid from source I would be used to import K. A similar conclusion, *mutatis mutandis,* would hold

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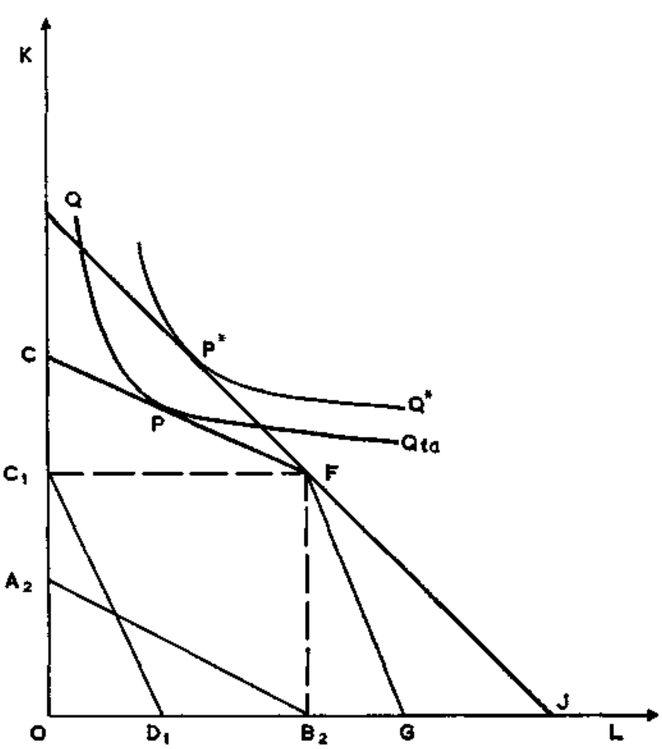
[a] The following analysis is reproduced, practically in its entirety, from the author's Graham Memorial Lecture at Princeton University, N.J. (25 April 1967) on "The Theory and Practice of Commercial Policy: Departures from Unified Exchange Rates" (to be published as a special paper in the *Princeton Series on International Finance*).

[b] Thanks are due to T. N. Srinivasan for showing how these two simplified versions of more complex models, designed by me to bring out the same points, are sufficient to demonstrate the emergence of multiple rates owing to aid-tying.

for the case where the maximal isoquant were to touch FG. If the maximal isoquant were to pass through F, however, there would be multiple rates and inefficiency unless, in the borderline case, the slope of the isoquant at F equalled JFQ.

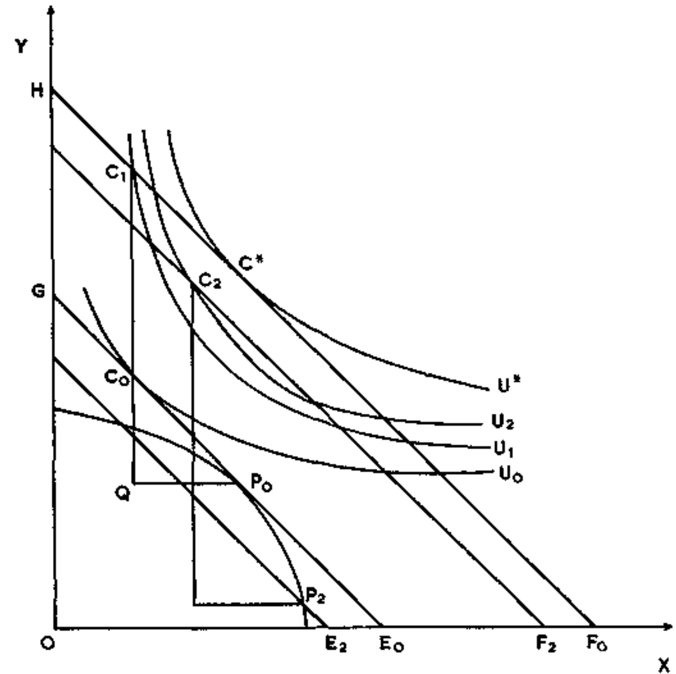
9. *Model III:* We now come to a model which is somewhat more complex, but realistic, with respect to the form of tying assumed. Assume that the so-called additionality principle is assumed, so that the recipient country must import specific commodities in full addition to initial imports. (A similar form of additionality with respect to source-tying can also be analysed, by extension of the present analysis.)

FIGURE II



10. Assume, for this problem, that two commodities are producible with domestic resources and the production possibility curve is a convex set. Additionality takes the form of requiring that, on top of existing pre-aid imports, the full value of aid must be imported in the specific form of importables. In figure III, for example, the country would have produced at P_0 and consumed at C_0 with P_0C_0 being the given price ratio abroad. However, when aid is given equivalent to E_0F_0 of X-goods or GH of Y-goods, C* would have been the optimal point of consumption and social welfare would have been U*. Suppose, however, that the aid-giver demands that (on the so-called "additionality" principle) the recipient should absorb altogether $(GH + C_0Q)$ amount of imports of Y. In this case, one possible equilibrium position, calling for a suitable consumption tax-cum-subsidy policy, is with consumption at C_1, production continuing at P_0 and with C_1C_0 of Y being absorbed as aid and with C_0Q of Y being imported in exchange for P_0Q of X. But a superior position is at C_2 with production at P_2, where total imports of Y, under trade and aid, continue to be at the required level, but welfare level has risen to U_2. Clearly, the optimal second-best policy under this form of tied aid constraint will involve suitable consumption and production of tax-cum-subsidy policies.

FIGURE III



11. In this case, which corresponds in spirit to the more usual analysis of bulk trading situations, the receipt of aid is conditional upon a certain pattern of trade and thus requires governmental intervention directly into the competitive system, for the market will not throw up the required pattern of trade on its own. Note again that the multiple rates are here the product of aid-tying and the inefficiencies they reflect are not to be interpreted as those resulting from inefficient policies of the recipient government.

12. Further, there may even be a dynamic reason here for departure from a unified exchange rate. It could be argued quite realistically that, even when such tying is not formally imposed, it is often considered to be "wise" to act as though it is, in the interest of future aid inflow. Thus, owing to this link between the current pattern of utilization of aid and the future aid inflow, it may be wise to forego some current income through treating the current inflow as though it were tied. Policies which thus appear to be inefficient from the current point of view may turn out to be fully rational, in economic terms, if the future is also considered.

Annex III

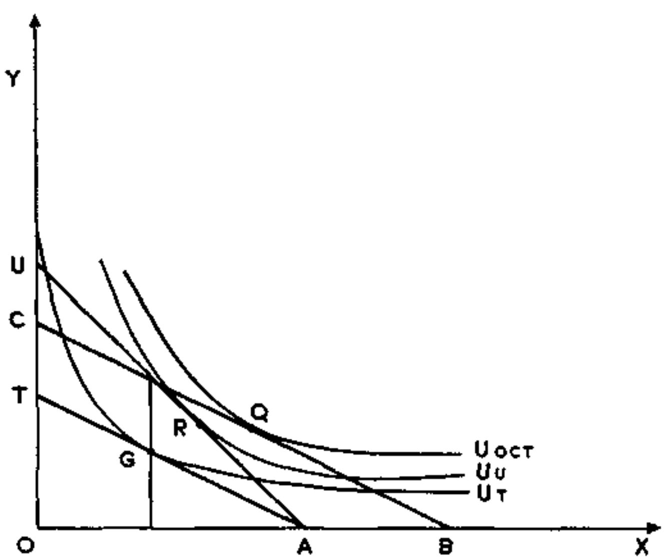
ESTIMATES OF EXCESS COST OF TIED AID AND POSSIBILITIES OF OVER-COMPENSATION AND UNDER-COMPENSATION

1. This annex demonstrates *(a)* how the method of estimating the cost of tied aid by finding out the excess cost of commodities purchased under tied aid policy may overestimate or underestimate the compensating flow of funds that would make the recipient country as well off under tied aid policy as it would be if the aid flow were untied instead; and *(b)* how the method of estimating the cost of tied aid by finding out the excess cost that would have to be paid for the bundle of commodities that was purchased under untied aid policy, now that the tied aid policy is imposed, would overestimate the compensatory flow of funds that would have to be paid to the recipient country so as to leave it as well off under the tied aid policy as it was prior to the tying of aid.

Estimation from bundle purchased under tied aid policy

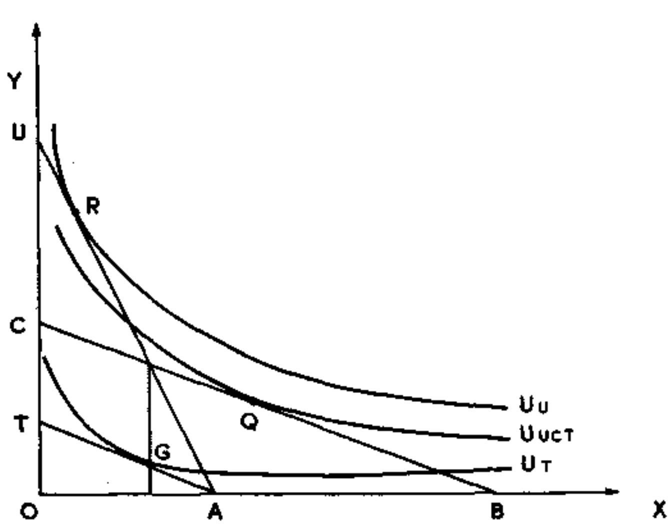
2. The possibility of over-compensation in this case is demonstrated in figure IV. AT represents the availability of combinations of X and Y from a given aid-flow if the aid can be spent only on source-tied basis. However, if the aid were untied, Y could be obtained cheaper from alternative sources and the availability line would then be AU. The bundle G would be demanded under tied aid, R under untied aid, and $U_u > U_t$. Suppose, however, that the recipient economy were to be compensated for the excess cost of the tied aid bundle chosen, namely G, the availability line would shift to BC, the bundle chosen to Q and this would lead to welfare $U_{oct} > U_u$, implying over-compensation for the loss resulting from aid-tying. Thus, the excess cost measure overstates the loss imposed by aid-tying.

FIGURE IV



3. The possibility of under-compensation is demonstrated in figure V. Here is illustrated the case where, computing the excess cost of the bundle G purchased under tied aid, given that the tied aid yields Y more expensively than untied aid (with AT and AU the availability lines from given aid flow under tied and untied aid respectively), and giving it to the recipient country such that its availability line now becomes BC, will result in under-compensation of the country for losses resulting from aid-tying ($U_{uct} < U_u$). Thus, in this case, the excess cost measure understates the loss imposed by aid-tying.

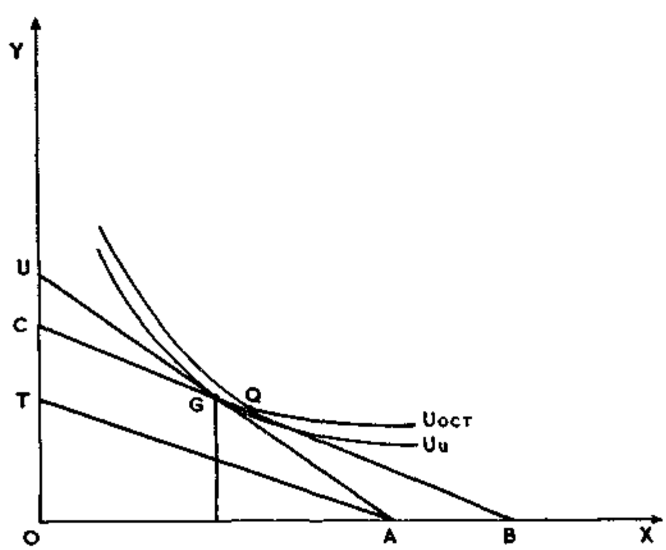
FIGURE V



Estimation from bundle purchased prior to tying

4. In this case, the excess cost measure will overstate the cost of tying. This is demonstrated in figure VI. AU represents the availability line under untied aid. Let G be the bundle actually purchased. If then aid were to become source-tied, thus resulting in an inferior availability line, AT, with Y more expensive (but not X) to procure from the tied source, then computing the excess cost of this bundle G and compensating the recipient country will lead to the new availability line BC and welfare at $U_{oct} > U_u$, with the new bundle at Q. Thus there will be over-compensation for the loss resulting from aid-tying and hence the excess cost measure will overstate the loss imposed by aid-tying.

FIGURE VI



5. This result is not surprising; it follows from Samuelson's well-known "over-compensation" theorem: if prices change and income is changed as to permit the consumption of the original bundle, then over-compensation will necessarily follow unless, of course, Leontief-type fixed consumption patterns are assumed.[a]

[a] It is implicitly assumed throughout the analysis in annex III that the effect of source-tying is to make the import prices of some (if not all) import items relatively more expensive to those of other commodities. If the prices of all commodities were to go up uniformly, then there would be neither over-compensation nor under-compensation, of course.

DOCUMENT TD/7/SUPP.8 *

The costs of aid-tying to recipient countries
Progress report by the secretariat of UNCTAD

[Original text: English]
[21 November 1967]

NOTE

The Agreed Statement of the Problems of Development, approved by the Committee on Invisibles and Financing Related to Trade at its second session,[1] referred, *inter alia*, to the importance of "the question of the role and effects of tied aid..." and called for further examination of the problem. In response to this request, the secretariat has initiated a series of studies of tied aid in a number of developing countries. The present document is a progress report on these studies. In addition, at the request of the UNCTAD secretariat, a general study of the subject has been prepared by Professor Jagdish Bhagwati.[2]

Chapter I

Introduction

1. The reasons for aid-tying are well known and need not be discussed here.[3] There is little doubt that aid-tying practices have been used increasingly by most developed countries in recent years. It is reasonable to suppose that at present at least three-fourths of total official bilateral assistance from developed countries is subject to restrictions on the source of procurement, in one form or another.

2. In order to obtain direct information on the costs of aid-tying to the recipient countries, the secretariat has initiated a series of studies of tied aid in a number of developing countries. The countries selected for examination so far are: Chile, Ghana, India, Iran, Pakistan, Tunisia and Yugoslavia. The present document is a progress report on the studies so far completed, namely, those on Chile,[4] Iran,[5] and Tunisia.[6] Work continues on the studies on Ghana, India, Pakistan and Yugoslavia. Reports on these countries will be submitted as they become available.

3. The selection of countries was determined entirely by availability of data. To the best of its ability, the secretariat made inquiries as to which countries had had experience of competitive bidding for aid projects and programmes and had kept records of such bidding in a form that would permit analysis. It was found that in many cases countries either do not invite, or do not succeed in obtaining, tenders in connexion with purchases under aid programmes, or that insufficient information is available concerning such tenders to permit meaningful analysis. Although the sample of countries is small, it is likely that the evidence yielded by these studies will provide some indication of the order of magnitude of the problem of aid-tying in developing countries.

4. Two different approaches have been used in the country studies. In some cases the necessary investigations have been undertaken by officials connected with the Governments concerned or by institutions in the public sector. This has been the case for Chile, India and Pakistan. In other cases, namely, Ghana, Iran, Tunisia and Yugoslavia, the secretariat has engaged qualified consultants to visit the respective countries for periods of up to a month and examine the information placed at their disposal by the Governments concerned.

5. In all cases, the instructions regarding the scope of the inquiry and the methodology to be used were in principle the same, although differences in the situations of various countries and in the records kept have naturally affected the nature of the analysis that could be carried out. The methodology recommended by the secretariat has been set out in the annex to the present document.

* Incorporating document TD/7/Supp.8/Corr.1.

[1] See *Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3* (TD/B/118/Rev.1), annex II.

[2] "The tying of aid" (document TD/7/Supp.4), to be found in this volume of the series.

[3] For an extensive discussion of the reasons and forms of tying, see Jagdish Bhagwati, *op. cit.*

[4] See UNCTAD, "Summary and evaluation of data relating to the utilization of tied credits to Chile" (document TD/7/Supp.8/Add.1), to be found in this volume.

[5] See Eprime Eshag, "Study on the excess cost of tied economic aid given to Iran in 1966/67" (document TD/7/Supp.8/Add.2), to be found in this volume, hereafter referred to as "Eshag, *op. cit.*, Iran."

[6] See Eprime Eshag, "Study on tied economic aid given to Tunisia in 1965" (document TD/7/Supp.8/Add.3), to be found in this volume, hereafter referred to as "Eshag, *op. cit.*, Tunisia."

Chapter II

Methods of tying aid

6. Aid can be tied to a particular source or to a particular project. A general definition of aid-tying by source should include all practices aimed at restricting the recipient country's choice in spending aid funds on imports from countries other than the aid source. Aid can be tied formally or informally, directly or indirectly. Formal restrictions are the clearest form of source-tying, and quantitatively the most important form, but by no means the only one. Aid may be source-tied informally through pressures exerted by the donor country on the recipient country. Also informal tying may result from the pressures of local dealers in the recipient countries themselves, or of other persons having special links with a particular donor country.

7. Direct tying can be defined as including those procurement restrictions which are automatically linked to the very provision of the aid. Directly tied aid includes aid in kind, technical assistance expenditures and export credits; it constitutes a significant proportion of total aid flows and can involve substantial excess costs.[7]

8. There are essentially two forms of applying "indirect" procurement restrictions. One method is to treat the aid flow as part of an over-all trade arrangement. The other consists of financing only those commodities or projects in respect of which the donor country appears to have a strong competitive position.[8]

Chapter III

The costs of aid-tying to the recipient country

9. Whatever the specific type of restriction, tying reduces the value of aid to recipient countries. One way to view this reduction in the value of aid is in terms of the "excess costs" incurred by the recipient as a consequence of the restrictions placed on the choice of the sources of supply. Another approach, in the case of tied loans, would be in terms of the higher effective rate of interest charged, since the repayments are larger than the "value" of the aid received, and usually have to be made in convertible currencies. If, for example, a tied development loan repayable in twenty years carries a 3 per cent rate of interest while the goods financed by the loan are priced at 30 per cent over the cheapest source of supply, the effective interest rate on the loan is close to 6 per cent.[9]

[7] Thus, for example, the scale of salaries and allowances paid to United States personnel working in an aid-financed project in Iran was estimated to be at least some 30 to 40 per cent higher than the pay of technicians of similar qualifications from other industrial countries working in Iran (see Eshag, *op. cit.* Iran, para. 36).

[8] Bhagwati, *op. cit.*

[9] It should, therefore, be understandable that in many such cases the potential recipient prefers to utilize its own foreign exchange resources rather than accept the tied loan. It is reported that in the case of Iran (Eshag, *op. cit.*, Iran), for example, some credits were occasionally not utilized because of the high excess costs attached to their use. Many developing countries, however, have such limited flexibility that their only alternative is to forgo the desired imports altogether.

10. The limitations imposed on the recipient country regarding the selection of source of supply are likely to give rise to costs of various types and magnitude, depending on the form of tying, on the characteristics of the recipient country's economy, and on the degree of its dependence on aid in general and on a specific donor country in particular. A first distinction should be drawn between those costs which the recipient country can avoid and those which it has to bear no matter how successfully it programmes its foreign exchange outlays and its sources of supply. A second distinction should be drawn between the direct and the indirect costs of tying.

11. The costs of tying can be partly avoided by judicious switching of sources of imports by the recipient country. Thus, the recipient country may be able to switch aid-financed imports from the tied source for its normal imports from the same source, and partially evade the restrictions imposed on the aid. It appears, however, that most developing countries do not enjoy the flexibility necessary for successful switching of imports.

12. Switching possibilities depend on several factors, many of a non-quantifiable nature. Generally speaking, switching possibilities are likely to be limited if the recipient country has relatively little "free" foreign exchange at its disposal (because available supplies of foreign exchange are already pre-empted for priority purposes), and if it is heavily dependent on the assistance of one donor country.[10] A low level of "free" foreign exchange implies that the country does not have much general manœuvrability for successful switching; heavy dependence on the assistance of a single country normally makes it difficult to evade aid restrictions by using an alternative source of aid.[11]

13. Successful switching also depends on efficient programming of imports and a complex process of this sort can scarcely be concealed from officials of the aid-giving country; efficient programming of imports would, therefore, be likely to lead to a tightening of procurement restrictions in the future and might even jeopardize the flow of aid itself.

14. The high degree of dependence of most developing countries on a single country as a source of aid and the inadequate availability of "free" foreign exchange indicate that most developing countries are in no position to evade much of the cost of tying. The ratio of net bilateral official aid from the largest single donor country to total net official bilateral aid received by the country in question can be taken as an index of the dependence of a country on an individual source of aid. This ratio has been calculated for developing countries for 1965.[12] For

[10] Other factors influencing switching possibilities are discussed in Bhagwati, *op. cit.*

[11] The country study on Iran illustrates one case in which, owing to a relatively comfortable foreign exchange position and to diversification of aid sources, tying was partly evaded through use of switching possibilities (see paras. 44, 47, and 50-51).

[12] Official bilateral aid (net of interest and amortization) from the largest single donor country divided by total net official bilateral aid received by the developing country in question. Both the numerator and the denominator exclude export credits. Assistance from multilateral agencies was not included in the denominator because it is untied.

most developing countries the dependence on one source of aid appears to be pronounced, the median ratio for all countries being 64 per cent. In terms of broad regional subdivisions, dependence of countries on a single source of aid seems highest in Latin America (64.9 per cent) and lowest in the Middle East (49 per cent). It also appears possible that the smaller among the developing countries may be more dependent on a single source of aid than the larger countries. If so, the smaller among the developing countries would enjoy more limited switching possibilities than the larger countries, especially since efforts to switch imports are likely to be more " visible " in smaller countries. The latter may, therefore, have to bear relatively higher costs for a given amount of tied aid.

15. The second distinction to be drawn is that between the direct and the indirect costs of tying. The direct costs can be defined simply as the excess of the delivered price actually paid by the recipient country over the lowest delivered price which the country would have paid had the aid not been tied.[13] In practice, direct costs can be estimated reliably only when international tenders have been invited or when standard price lists exist.

16. Indirect costs can be classified into the following three broad categories:

(a) Excess costs on purchases related to the original (tied) purchase. Relatively minor differences in the cost of the original purchase often mask far more significant differences in the cost of spare parts or inputs.[14]

(b) Costs arising out of monopolistic practices by suppliers from the tied source. It has been shown[15] that the direct costs of tying are likely to be higher if suppliers from the tied source are aware of the limited range of choice available to the recipient country and are allowed to take advantage of this position. Indirect costs, in the form of foregone benefits, are also likely to result from such a situation. Thus, the knowledge that the recipient country is not in a position to choose its source of supply may often allow the supplier in the tied source to avoid providing the " fringe " benefits which would normally accrue to the purchasing party in a commercial contract. These may include a lack of interest in the servicing of machinery, inadequate follow-up of projects, failure to assist in the training of local personnel, etc.

(c) " Developmental " costs: these are probably the most significant of the indirect costs. Restrictions on the source of imports may seriously interfere with plan formulation and implementation and with the choice of appropriate technology, and they are no less real for not being quantifiable or " visible ". Thus, plan formulation may be unduly influenced by the uncertainty of not knowing how much of the expected inflow of aid will be source-tied, and in what form; also, the selection of projects may be unfavourably affected by limitations placed by the donor country on the eligibility of specific commodities for aid financing. The delays and uncertainties implied in aid-tying practices may aggravate the well-known difficulties of plan implementation and of project follow-up in developing countries. Procurement restrictions may also lead to the adoption of techniques unsuited to the economic characteristics of the importing country. Replacements for certain types of equipment bought under tied aid may have to be procured from the same source, even if they are purchased with the country's own resources.[16]

17. The above discussion can be very broadly summarized as follows:

(a) most developing countries, and particularly the smaller among them, are not in a position to evade much of the cost of tying; and

(b) the direct costs are only a part of the total costs of procurement restriction on aid: the indirect costs, though not easily quantifiable, are also significant.

Chapter IV

Empirical estimation of the direct costs of aid-tying

18. The evidence presented for Chile, Iran and Tunisia in this preliminary progress report may not necessarily be typical of developing countries in general, and relates to the direct costs of tying only. Moreover, the estimates are subject to a number of qualifications. A first qualification results from the difficulty of quantifying excess costs in the case of technical assistance. Differences in wages and salaries paid to various experts can be determined, but such differences can in many cases be only indicative, owing to the differences in qualifications and

[13] For a discussion of direct costs under different forms of tying see Bhagwati, *op. cit.*

[14] Thus, for example, the higher cost of motor buses imported with tied credits from the United States by Tunisia in 1965, relative to the cost of similar buses from other countries, accounted for only a part of the excess cost of tying; it was found during interviews that, owing to the need for more frequent repairs and to the higher cost of spare parts (30-50 per cent), the buses imported from the United States carried a total excess cost significantly higher than a comparison of purchase prices would indicate. The same was true of locomotive imports; there was the added disadvantage in both cases of longer delays in the delivery of spare parts (Eshag, *op. cit.*, Tunisia, paras. 38 and 61).

[15] Bhagwati, *op. cit.*

[16] A specific example may serve to illustrate the several types of costs discussed above. Suppose that donor country A finances on concessional terms the purchase of an automobile assembly plant by recipient country B, on condition that all equipment is to be imported from country A, owing to the partial complementarity existing between a specific plant layout and various plant inputs, purchases by country B of engine and body parts, tyres, batteries, paints, etc., will also be partly tied to country A, even though these purchases are not aid-financed. A sizable sector of country B's economy may then come to be *de facto* tied to imports from country A. Further it is possible that the past pattern of imports may lead country B, when substituting domestic production for these imports, to adopt techniques somewhat closer to those of country A than if it had had a free choice of source of imports for the automobile assembly plant in the first place. The total costs to country B of the original procurement restrictions may then include any or all of the following: the excess costs of purchasing the assembly plant from country A rather than from the most economical source, the excess costs of related inputs, spare parts, maintenance and repairs, the costs of deviating from an optimal investment programme due to the artificial stimulus or delay of import-substituting projects, the bias toward techniques unsuited to the country's *de facto* endowments. The excess direct costs are thus only the initial portion of the total costs of tying.

type of expertise of experts from various countries, even though they may be given the same functional classification.

19. A second set of limitations derives from differences in products specifications, which make it difficult to compare products from different sources. Except in the case of standardized commodities, price differentials might wholly or partly reflect quality differentials rather than "excess" costs. This difficulty, which is usually slight in the case of small purchases of relatively standardized items, becomes a serious one when the attempt is made to compare alternative costs for entire projects. Indeed, since no two large, integrated projects from different sources are based on identical technology, accurate comparisons could be made only through a detailed analysis of the costs and of the technical coefficients of production for each project, a task which is beyond the scope of an inquiry on the present scale. In general, the possibility that quality differences partly account for price differences will imply a partial overestimation of the direct costs of tying.

20. Thirdly, the problems of estimating cost differences are further compounded by the fact that the data available may not (and usually do not) show the full range of prices which would have been available had the aid-financed purchases not been tied to a particular source. International tenders may not have been requested or they may not have been allowed by the donor country. Even if requested and allowed, bids from elsewhere than the tied source may not have been forthcoming: where the recipient country is heavily dependent on one large donor and has limited "free" foreign exchange at its disposal, potential suppliers are understandably not inclined to undergo the expense of tendering for a contract they know they have little chance of obtaining since the finance is tied to imports from another country. To the extent that this difficulty does apply, estimates of the costs of tying will have a downward bias.

21. Fourthly, aid tying is a very delicate subject, and data are particularly hard to come by. Country estimates can, therefore, never be comprehensive, and are of necessity based on a relatively small sample of tied purchases. Also, there is always the possibility that the results from the limited sample may not be typical, and the bias can be either upwards or downwards. It is important to keep the above qualifications in mind when evaluating the actual results, which should be considered as preliminary. These results do, however, appear to be significant indications of the extent of the problem which developing countries are now facing.

(a) *Chile*[17]

22. The data collected were classifiied according to the system evolved by Mahbub ul Haq[18] and relate to a sample fifty-one tied credits in 1964-1967. The credits analysed, most of which were from the United States, amounted to a total of about $30.5 million, or about 10 per cent of total official bilateral and multilateral assistance received by the country in this period. However, international tenders were asked and received for only nineteen of the fifty-one covered. The purchases on which estimates of excess cost could meaningfully be made amounted to only about $180,000, or less than one per cent of the total amount of credits in the sample. The average percentage of excess cost on the sixteen purchases for which estimates could be made works out at about 12.4 per cent (see table 1 below).

23. It is striking that international tenders seem to have been obtained only for quite small purchases, mostly ranging from $5,000 to $20,000. This appears consistent with the view expressed earlier that suppliers will tender only when there is a reasonable chance of obtaining the contract, or when the purchase is of relatively standardized items (for which the cost tendering is minimal), which are likely to be of low value. There is little question that for large, diversified purchases the high cost of tendering and the low flexibility enjoyed by the recipient country are factors limiting the offer of tenders from alternative suppliers, even when the recipient country is allowed to invite them.

24. There are reasons to believe that the average percentage of excess cost on small purchases tends to be considerably lower than that applying to large procurements. There is a strong *prima facie* presumption that the absence of international tenders for the larger purchases led to excess costs higher than those applying to cases where competitive bidding was secured. Also, the data show that tenders from within the tied source itself are likely to be higher in the absence of international tenders, owing to the lack of a standard of comparison to which the recipient country can refer. Finally, the switching possibilities open to the recipient country are more limited where sizable purchases are concerned, particularly when the recipient country is highly dependent on the aid of a single donor country (as Chile is). It appears reasonable to assume, therefore, that the 12.4 per cent estimate made is, in the case of Chile, a considerable underestimation of the average percentage of excess direct costs of aid-tying.

(b) *Iran*[19]

25. The study covers the year 1966-1967.[20] The total inflow of capital in the form of tied aid during that year amounted to $56.7 million, of which about $8 million consisted of financial transactions — advance payments on account of future procurements — and the remainder (about $49 million) represented actual disbursements on goods and services procured in connexion with 15 development projects (specified in table 2 of the Study).

[17] The following account is based on data compiled by the Corporación de Fomento de la Producción of Chile. These data are presented in document TD/7/Supp.8/Add.1 below.

[18] See Mahbub ul Haq, statistical appendix to "Tied credits—a quantitative analysis," in John H. Adler and Paul W. Kuznets, eds., *Capital Movements and Economic Development: Proceedings of a Conference held by the International Economic Association* (London, Melbourne, Toronto, Macmillan and Co., Ltd.; New York, St. Martin's Press, Inc., 1967), p. 326.

[19] See Eshag, *op. cit.*, Iran.

[20] Iranian calendar year 1345, ending on 20 March 1967.

TABLE 1

Utilization of tied United States Agency for International Development. (USAID) credits by Chile, selected projects, 1964-1967 [a]

($U.S.)

Abbreviated description of purchase	*Year*	*Lowest international bid (f.o.b.)*		*Price actually paid to United States supplier (f.o.b.)*	*Excess cost (as percentage of lowest international bid)*
1	*2*	*3*		*4*	$5 = \frac{4-3}{3} \times 100$
1. Reclosers	1964	2,170	(Japan)	5,775	166
2. Disc insulators	1964	6,093	(Japan)	8,425	38
3. Steel cables	1964	7,005	(Switzerland)	7,205	3
4. Cables	1964	9,114	(Belgium)	9,490	4
5. Cables and connectors	1964	15,785	(France)	17,241	9
6. Rotary compressors	1965	24,142	(United Kingdom)	29,759	23
7. Light truck	1965	8,456	(United Kingdom)	10,367	23
8. Meters	1965	8,799	(Netherlands)	9,888	12
9. Power grader	1965	17,475	(Federal Republic of Germany)	19,360	11
10. Grinding-wheels, with spares	1965	1,795	(United States of America)	1,795	—
11. Insulating oil	1966	4,980	(United Kingdom)	5,378	8
12. Tractors	1966	10,760	(United Kingdom)	10,915	1
13. Mercury vapour lamps	1966	2,598	(Switzerland)	2,687	3
14. Telegraphic components	1966	2,746	(Switzerland)	2,779	1
15. Spare parts for locomotives	1967	23,780	(Federal Republic of Germany)	24,973	5
16. Tractors	1967	33,900	(United Kingdom)	35,924	6
Average		11,224		*12,622*	*12.4*

Source: UNCTAD secretariat, from data collected and classified by the Corporación de Fomento de la Producción of Chile (see below, document TD/7/Supp.8/Add.1).

[a] The purchases included are those for which international tenders were invited and received.

26. Owing to limitations of both data and time, quantitative estimates of the excess cost of tying were confined to six projects, the other nine projects being examined only in a general way. The six projects for which estimates were made accounted for a disbursement of over $9 million (20 per cent of total procurements under tied aid).

27. The excess cost of aid on the six projects is estimated at about $1.4 million, which is equivalent to about 15 per cent of the total disbursements made on these projects. The author considers that the average percentage of excess cost of total tied economic assistance in 1966-1967 would be considerably lower and probably in the region of 10 per cent of the disbursements or even less. The reason given for this opinion is that the average percentage of excess cost borne on the nine projects for which no quantitative estimates were attempted was, by all indications, considerably lower, since most of these projects had been subject to international invitations for tenders.

28. One important finding, confirming observations made earlier in this paper (see paras. 11-14), is that Iran, by obtaining its aid from several countries and in general enjoying a relatively easy foreign-exchange position, has been able to limit the cost of tying by using opportunities for switching sources of imports and giving wide circulation to project tenders.[21]

29. Although the primary objective of the study is to estimate the magnitude of direct costs, it also gives a number of illustrations of the indirect costs incurred. Such costs arose through excessive prices for spare parts, through the purchase of certain equipment which was

[21] One example among the several reported in the study will help to illustrate this point. One of the purchases examined involved a standard product (U.33 heavy type rails) so that price differentials due to quality differences could be disregarded. The lowest price per ton (C and F) quoted from the United States was $160.77, as against a bid of $114.00 from country A and $110 from country B. The Iranian authorities thus used the country's own cash resources to buy 32,140 tons of rails from country B, for a total saving of over $1.6 million. Moreover, by disclosing to country A country B's lower bid, they succeeded in obtaining from country A a better price on a related purchase in exchange for buying rails from it (see Eshag *op. cit.*, Iran, paras. 43-45). The study concludes, however, that some of the poorest developing countries ... are least able to avoid the excess costs of tied aid (*ibid.*, para. 7).

found to be not wholly suited to the requirements of the country, through long delays in the delivery of some goods and through the administrative difficulties involved in managing certain projects.[22]

(c) *Tunisia*[23]

30. The study covers the year 1965. Of the gross inflow of about $113 million of development capital (bilateral and multilateral) in that year, official source-tied aid amounted to about $74.5 million. About $41 million,[24] representing goods and technical assistance services, was subject to direct tying. The United States accounted for about 50 per cent of the total inflow of development capital and for over 60 per cent of the official source-tied aid.

31. Owing to limitations of time and data, quantitative estimates of the excess cost of aid were confined to disbursements made under United States commodity-loan agreements and under certain project development loans. Total disbursements for which estimates were attempted amount to about $17 million, accounting for over 20 per cent of the tied aid received in 1965.

32. The estimate of the excess cost borne under commodity-loan agreements is based on equalization *(péréquation)* — the difference between the c.i.f. value of goods imported under USAID loans and the prices charged to local merchants by the Government of Tunisia. The purpose of this equalization is to enable the merchants handling the USAID-financed imports to earn a reasonable profit on those goods for which United States prices are appreciably higher than the prices of the alternative sources of supply.[25]

33. The total amount of equalization for 1965 is estimated at $1.7 million; this is equivalent to 18 per cent of the c.i.f. value of imports under commodity-loan agreements tied to the United States source.[26] The estimates of equalization, as indication of excess cost for individual commodity groups, were cross-checked, wherever possible, by a detailed examination of invoices and quotations from the United States and other countries and by interviews with business men and public officials. On the basis of this work, it was considered that a round figure of 20 per cent would represent a reasonable and conservative estimate of the excess cost borne on the USAID commodity-loan aid tied to United States sources.

34. Of the ten projects financed by USAID project-tied aid and by Export-Import Bank of Washington (Eximbank) loans, only the three major ones, which together accounted for $8 million, or over 70 per cent of the total project-tied disbursements in 1965, were examined. The estimate of excess cost for these projects (20 per cent) is based on a less clear and precise foundation than that made for commodity-loan aid and is subject to a wider margin of error in either direction.

35. Thus, 20 per cent can be taken as a very conservative estimate of the order of magnitude of the direct cost of aid-tying borne by Tunisia on United States tied assistance given under commodity-loan agreements and through project development loans during 1965.

36. In addition to the examination of direct costs of tied aid, the study also gives a number of specific illustrations of the indirect costs. These are generally of the same nature as those mentioned earlier in the case of Iran — high prices for spare parts, delays due to long distances, unsuitability of certain goods to local conditions and administrative complications caused by language barriers.[27]

(d) *Other estimates*

37. Two empirical studies, among others, were carried out before the UNCTAD country study series. One, by Mahbub ul Haq, relates to tied credits to Pakistan in 1960-1963, while the other, by Bhagwati, uses aggregate data to reach estimates broadly applicable to tied aid as a whole.[28] The Mahbub ul Haq study estimates excess costs by comparing the lowest bid from the tied source with the lowest international bid. On the basis of a sample of twenty development projects, the study reaches the conclusion that "the weighted average price for these 20 projects comes out to be 51 per cent higher from the tied source compared with the international bids", and that "the tying up of foreign credits raises the average price of procurement for Pakistan by about 12 per cent".[29] The former estimate was obtained by comparing bids, rather than the actual price paid, to the lowest price available. It is therefore an estimate of the range of cost which can be incurred owing to the tying of aid, rather than an estimate of actual cost incurred.

38. The estimate obtained by Bhagwati is also an estimate of the potential cost of tying rather than of the actual cost. On the basis of International Bank for reconstruction and Development (IBRD) and International Development Association (IDA) data, and by calculating the spread of bids on IBRD and IDA contracts, Bhagwati concludes that "the percentage of potential excess cost, measured as the ratio of the diff-

[22] See Eshag, *op. cit., Iran*, paras. 35, 37, 38 and 41.

[23] See Eshag, *op. cit.*, Tunisia.

[24] An additional $1.8 million consisted of directly tied export credits.

[25] The reliability of equalization as an indicator of the excess cost of tying depends on the correspondence between internal prices and world prices. If the former are influenced by domestic taxation or by tariffs, as they normally are, the equalization method will overestimate or underestimate the excess costs of tying. In the case of Tunisia, cross-checks of the estimates indicate that internal prices were influenced by domestic policies in such a direction that the equalization method turned out to underestimate consistently the excess costs of tying.

[26] See Eshag, *op. cit.*, Tunisia, annex, table 5.

[27] *Ibid.*, paras. 38, 39, 49 and 61.

[28] Bhagwati, *op. cit.*

[29] See Mahbub ul Haq, *op. cit.*, pp. 327-331.

erence between high bids and successful bids to successful bids, was on the average 49.3 per cent, and that over 31 per cent of the value of contracts awarded... were characterized by potential excess cost of over 50 per cent, and 62.9 per cent of the value of contracts awarded were characterized by potential excess cost of over 30 per cent ".[30] The author himself points out that there are good reasons to believe that a result in terms of potential excess cost of the highest bid received is merely indicative of the possible ceiling on actual excess cost.

[30] Bhagwati, *op. cit.*, para. 90.

(e) *Concluding remarks*

39. The country studies so far completed show that, while it is difficult to make precise estimates of the direct costs of tying to recipient countries, reasonably reliable indications of the magnitude of such costs can be obtained. The country results reflect cautious estimating procedures and the excess cost estimates can be considered as conservative. Although more definite conclusions on this matter would have to await additional evidence, it is possible to conclude tentatively at this point that, on balance, the tying of aid entails significant direct costs for the recipient countries, and that these costs are likely to average at least 10-20 per cent.

ANNEX

UNCTAD tied aid project methodology [a]

A. Cost of tied aid: methodology for data collection and classification

Objectives: To obtain estimates of the price premiums that countries are paying on the average on goods obtained under tied aid.

Period: The last year for which comprehensive data are available, including data on the commodity distribution of aid. Preferably 1965 or alternatively 1964.

Nature of data to be obtained: For each product or project, the attached form should be filled out.

With respect to particular entries, attention is called to the following illustrations or explanatory remarks:

Product or project (e.g. " Diesel engines ", " Boiler plant ").

Country of bidder or tenderer. Include all bids or at least the lowest acceptable bid from each of the main countries of interest.

Item 1, item 2, etc. On many bids separate price data are given for a number of different items. When all these fall within the same 4-digit SITC classification, they should be treated as a single item. When they fall in different classes, they should be treated separately. For each item, give the following information:

1. Name of the item.

2. SITC classification (on 4-digit basis).

3. Append a brief description of each item, including quantitative specification (size, power, capacity, etc.) where appropriate.

4. Basis of price quotation (f.a.s., c.i.f., etc.). If both f.a.s. (or f.o.b.) and c.i.f. prices are given, give both, using separate columns.

5. If bid prices have been evaluated for differences in specifications and adjusted to a comparable price basis, indicate these prices in a separate column. Place in footnotes other comments relating to such particulars as delivery time, prior experience with supplier, and deviations from specifications that affect purchase decisions.

Action taken: Describe briefly whether the project was undertaken and whether the tied source was utilized or a non-tied source. Indicate also if no shifting of source was possible, or any unusual features of the bidding, such as the failure of some sources to respond to an invitation to tender.

The number of price comparisons in each category should, as far as possible, reflect the relative importance of the category in question in total aid imports.

Source of data: The investigator should avoid himself deciding whether price quotations relate to comparable products but should obtain this information from the agency responsible for purchasing, or for checking prices, etc.

The principal sources will be:

(a) Government purchasing agencies

(b) Government agencies responsible for checking prices

(c) Development banks

(d) Major private importers.

UNCTAD tied aid project

Country:
Date:
Prepared by:

Product or project:

Date of tender or bid: *Currency in which prices are given:*

Purchasing agency:

Source of finance:

Country of bidder or tenderer	*Item 1* (SITC...)	*Item 2* (SITC...)
1.		
2.		
3.		
4.		
5.		
6.		
7.		

Action taken:

[a] The following abbreviations are used in these instructions:
SITC: Standard International Trade Classification
c.i.f.: cost, insurance, freight
f.a.s.: free alongside ship
f.o.b.: free on board

B. Cost of tied aid: methodology of calculation

This note sets out the methodology of calculating tied aid from the data that can be secured from the recipient countries to which UNCTAD is sending out consultants.

1. *General points*

The method that we should use involves essentially the "cost difference" approach. This involves estimating the excess cost of the bundle of goods that was purchased under tied aid (and thus essentially requires information on the composition of these imports and on the excess costs of obtaining them from the tied source). This approach presupposes that what we are interested in is the actual cost incurred by the recipient country, as revealed by the data.[b]

2. *Actual guidelines*

Step 1: The consultant must choose a fairly recent year, 1964 or 1965 depending on data availability, for his calculations. The question of data availability refers to both the composition of tied aid imports and price quotations giving the excess cost of procurement from tied sources; hence the optimal date will involve reference to both these issues.

Step 2: The consultant must try to get, as accurately as he can, and by SITC categories, if possible, the composition of the imports secured by tied aid. This may be difficult in some cases, as when the composition is available only in terms of all aid; in such cases, the consultant must try to make his own estimates, by methods to be made explicit in his report, of the composition of imports under tied aid alone. The consultant might be able to piece together the relevant information by examination of aid projects, interviews, etc.

Step 3: The next step would seem to be to try to break down this composition by project and non-project aid. The reason is that, with project aid, it will usually be possible to get the required information on the excess cost of tying much more readily in many cases.

Step 4: For project aid: sub-divide the problem into three categories:

(i) *Projects for which tenders were invited internationally.* In these cases, it will be possible to infer quite readily, from the price quotations and by interviews, whether the lowest bids were accepted and, if not, whether the cost was higher because the project was *de facto* tied to one source, and the higher cost, tied source had to be accepted. In making this estimation, the consultant must remember that the project may have been associated with some tied source despite international tenders and that, therefore, bids may be only from one firm or one source: In this case, cross-checks must be made with officials who have dealt with the question and the project, to find out if the spread of bids, if any, represents at all a reasonable estimate and whether acceptance of the lowest bid from very few bids received does not miss out the fact that, if the project had been believed to be genuinely "open" to all parties, there would not have been very much lower bids. In short, the consultant must remember that international tenders to not necessarily imply that there was no excess cost from tying to one specific source.

(ii) *Projects where tenders were not invited but alternative quotations were procured.* In these cases, the consultant will be able to get hold of the alternative quotations readily from the procurement agencies or officials. It should be remembered, however, that information secured on this basis, when actual bids are not made, may be highly coloured and misleading. Cross-checks and insistence on obtaining the precise details on what would have cost less from alternative sources would be very helpful.

(iii) *Deferred or suppliers' credit projects (if any).* In these cases, the projects may not have gone through alternative source possibilities and the mere availability of credits from a particular country or institution may have led to the acceptance of a project from a given source. To secure reasonable quotations on the excess cost of obtaining these imports, for projects so financed, the consultant will necessarily have to rely on actual importers, whether private or governmental as the case may be, for the necessary information.

Step 5: For non-project imports, again, the method of procuring the information will involve resort to official agencies and preferably private importers, who should be told what exactly is expected of then. It should be explained to them how additional monopoly charges can arise from tied aid, and they must be asked to supply full details on what precise products they are talking about when they refer to excess cost estimates. Otherwise, they are likely to give unreliable answers.

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[b] The consultants should note that this method of calculating the cost of tied aid does not take into account the fact that the recipient country might have been able to reduce the costs of tying still further (by, say, a better procurement policy) even within the context of tying. The consultants should keep this point in mind and would be well advised to look out for improvements in existing procurement practices and aid disbursement and planning procedures that leave scope for reducing the cost of aid-tying even though aid continues to be tied as previously.

DOCUMENT TD/7/SUPP.8/ADD.1

Report on tied credits — Chile: note by the secretariat of UNCTAD

[Original text: English/Spanish]
[8 December 1967]

Introduction

1. At the request of the Secretary-General of UNCTAD, the Corporación de Fomento de la Producción (CORFO) of Chile has collected and classified data relating to the utilization of tied credits by Chile in recent years. The data and an explanatory note prepared by CORFO are set out in the attached study. The major results of this study have been summarized in the paper " The costs of aid-tying to recipient countries: A progress report by the UNCTAD secretariat ".[1]

Purpose

2. The purpose of this study is, first, to estimate the difference between, on the one hand, the prices paid by importers to suppliers of equipment purchased with tied credits or the prices quoted by these suppliers and, on the other hand, the lowest figures quoted by other sources for equipment of exactly the same type, and, secondly, to give the reasons for the difference. In the latter case, the formulation and implementation of the policy governing each particular loan had to be analysed both at the level of the government agencies concerned with securing and distributing these loans, and at that of the recipients of the credit.

Methodology

3. Goods purchased with tied external aid usually cost more than goods available on the open market. Moreover, the excess cost of the former varies from country to country and, within different countries, varies with the type of machinery and equipment required. This being so, special attention has had to be paid in this study to certain aspects of credit policy. These include the way in which each particular loan was allocated for the various possible uses, how the quotations were obtained and what governmental measures were adopted to prevent the suppliers of tied credits, or their agents, from making excessive profits and the credits themselves from being used as a device for transferring capital abroad.

4. This meant that the necessary data had to be obtained on all the loans secured during the past four years. Official records failed to provide much of the background data needed and some recipients were loath to give the information requested of them. Accordingly, the analysis has had to be confined to the cases — broken down by private and public sectors — in table 1. The layout of the table is based on the model presented by Mr. Mahbub ul Haq at the Conference on Capital Flow and Economic Development of the International Economic Association, held at Washington in July 1965.[2] In the case of the private sector, a breakdown of the prices which had some bearing on the decisions, but were not the figures finally accepted, was unobtainable.

5. No data were collected on changes in credit or supply sources, nor on the quotations which led to those changes being made.

6. Tenders were deemed to have been invited if the recipients could satisfy the researchers that a number of manufacturers had been asked to submit quotations. Publication of tenders in the press or a written record of the different prices were not considered essential prerequisites.

7. Goods, machinery and equipment were deemed to be " of exactly the same type " if so regarded by the recipients of the credits.

8. Every quotation mentioned in this study was obtained by tender, according to the recipients of the loans. The authors made no estimates of prices because, in their view, the figures supplied by the recipients of the credits were comparable.

Conclusions

9. In some cases, only suppliers in the country offering the tied credits were invited to tender. When other countries were allowed to bid, quotations were generally lower.

10. Systematic procedures designed to secure price quotations from more than one source are applied by only a few agencies concerned with loan administration. As a rule, applicants for credit from the private sector have not been required to submit more than one quotation, and the question of price increments due to

[1] See above, document TD/7/Supp.8, paras. 22-24.

[2] See " Tied credits — a quantitative analysis ", in John H. Adler and Paul W. Kuznets, eds., *Capital Movements and Economic Development: Proceedings of a Conference held by the International Economic Association* (London, Melbourne, Toronto, Macmillan and Co., Ltd.; New York, St. Martin's Press, Inc., 1967), p. 326.

middlemen has not been investigated. Nor have missions been sent abroad regularly to ascertain which were the most suitable credit sources or direct suppliers.

11. Agencies have in some instances decided not to make use of loans granted to them but to avail themselves of other sources of tied credit or to use untied foreign exchange. The decisions were taken not so much in order to reduce high quotations as to reduce or avoid the formalities involved in tied aid, considered by the borrowers to be generally unduly protracted and, at times, too costly.

12. A shortage of credit and of untied foreign exchange is all that has prevented a more general application of the policy of securing loans from less expensive or more flexible sources.

13. Payment of commissions to agents has, on occasion, been avoided by dealing direct with suppliers.

14. Credit policy has apparently given ample opportunity for capital to be transferred abroad. This is so because the action of loan-administration agencies ends with the allocation of loans in the light of the data submitted by the applicants.

15. Use of tied loans in the public sector during the period under review did not always result in overpayment for the goods purchased. When that did happen, however, the cost was inflated by as much as 166 per cent.

16. The research conducted in the preparation of this study, although the results were not stated in figures, left the authors with the impression that the excess costs paid by the private sector were at least as high as those exacted from the public sector.

17. The fact that the recipients of tied credits seem to have shown little concern for machinery and equipment prices may be due to the absence of competition from the domestic market, not only between foreign and domestic industries, but also between domestic industries themselves. This lack of competition usually means high profits and small reductions in the cost and price of manufactured goods.

18. While prices have had some bearing on the decisions taken by enterprises in respect of their purchases, these decisions have been influenced perhaps as much or even more by such factors as:

(a) The inability to obtain equipment and machinery on easier credit terms from other sources;

(b) Confidence that the suppliers chosen are in a better position to meet the agreed delivery deadlines;

(c) Lower operating costs;

(d) Satisfactory performance of equipment obtained from the same source in the past and reluctance to diversify the industry's capital goods;

(e) Previous use of equipment from the same manufacturer;

(f) Use of the same machinery by other enterprises in the same branch of industry;

(g) Recommendations of government officials;

(h) Selection based on data supplied by the manufacturers;

(i) Subsidiary companies purchasing equipment manufactured or used by their parent firm.

Examples of prices paid with tied credits

Country or agency granting the credit	*Project*	*Particulars of purchase*	*Date on which tenders were invited*	*Were international tenders invited?*	*Lowest quotation from tied credit source*	*Lowest international tender*	*Percentage of excess cost of tied credit source*	*Quotation finally accepted and supplier country ($U.S.)*	*Remarks*
				A. PRIVATE SECTOR					
United States Agency for International Development (USAID)	Modernization of the fisheries industry	Five Cummings Marine engines	1965	Yes	...	...	—	75,825 c.i.f. United States of America	This transaction has not yet been finalized. More suitable and more up-to-date engines are being purchased to replace those in current use. Under the provisions governing USAID credit the purchase was made in the United States. Similar terms and prices were offered in the Federal Republic of Germany.
Inter-American Development Bank (IDB)	Expansion of the fisheries industry	Equipment for a fish flour and oil plant. Standard Steel Co.	1965	Yes	...	...	—	279,720 c.i.f. United States of America	This equipment was purchased by CORFO and transferred to the company concerned. More suitable plants at similar prices were available in Norway and Denmark.
France	Expansion of the merchant marine	Vessel for the transport of liquid petroleum gas or anhydrous ammonia. Chantiers Navals de la Ciotat, French shipbuilders	1966	Yes	...	...	—	3,571,428 f.o.b. France	The recipient company probably selected the French market because, in addition to the credit terms offered, all its other vessels are of French manufacture and 25% of the shares are held by a French shipping consortium.
Switzerland	Installation of a new food industry	Drying oven for vegetables and greens, with conveyor belt, Swiss manufacture	1966	Yes	...	...	—	70,494 f.o.b. Switzerland	The industrialist concerned personally visited European manufacturers of this equipment and selected the one he considered to be most suitable.
Germany, Federal Republic of,	Expansion of the soap industry	Automatic machine for packing and sealing cardboard cases Höfliger Karg (Germany, Federal Republic)	1966	No	...	...	—	20,675 f.o.b. Germany (Federal Republic)	The main reason for selecting this equipment was that it operated satisfactorily in another domestic industry.
Italy	Expansion of the soap industry	Rolling machines for the manufacture of soap— Meccaniche Moderne	1966	No	...	...	—	12,089 f.o.b. Italy	This equipment was selected to supplement existing machinery from the same firm.
Italy	Expansion of the food industry	Equipment for the preservation and glazing of fruit, with accessories —Carle e Montanari	1966	Yes	...	...	—	60,685 f.o.b. Italy	The recipient firm, 73% of whose capital is held by G.B. Ambrosoli of Italy, operates through its head office.

Italy	Installation of a new wire nail manufacturing industry	Wire nail manufacturing equipment and accessories — Emilio Wartenweiler (Italy)	1966	Yes	...	...	—	23,351 f.o.b. Italy	The company selected this equipment because it consists of fewer machines and operating costs will therefore be lower.
Italy	Expansion of the metallurgical industry	Foundry equipment and accessories	1966	Yes	...	...	—	178,113 f.o.b. Italy	The industrialist concerned personally called on the chief manufacturers of this equipment. He observed it in operation in similar industries and decided to purchase it.
Italy	Expansion of the metallurgical industry	Equipment manufactured by the Italian firm Boldrini	1966	Yes	...	...	—	130,780 c.i.f. Italy	An engineer from the purchasing company obtained the quotations and inspected the equipment in operation.
Italy	Expansion of the metallurgical industry	Fourteen presses manufactured by the Italian company Luigi Dellavia J.C., with accessories	1966	Yes	...	...	—	181,280 f.o.b. Italy	The quotations were made directly by an engineer from the purchasing company who saw this equipment in operation. Moreover, there had been some experience with it since the firm had already used it in the past. The full credit of US$300,000 could not be used up because of the the strict deadline imposed by the Italian Government.
Italy	Expansion of the metallurgical industry	Equipment manufactured by the following firms: V.U.L.F. di A. Locatelli, Industria Meccanica Villasante, Mariani, Costruzioni Meccaniche Pasquino, Galdabini S.p.A.	1966	Yes	...	...	—	26,887 f.o.b. Italy	Quotations for this equipment were obtained in person by a representative of the industry in Italy.
Italy	Expansion of the metallurgical industry	Milling machine of Italian manufacture	1966	Yes	...	...	—	31,600 c.i.f. Italy	Quotations were obtained from several suppliers in Europe on whom the chairman of the company called personally.
Switzerland	Expansion of the metallurgical industry	Drills and lathes	1966	Yes	...	...	—	57,231 f.o.b. Switzerland	
France	Expansion of the metallurgical industry	Milling machine, presses and accessories	1966	Yes	...	...	—	378,911 c.i.f. France	
IDB	Expansion and modernization of the forestry industry	Mechanized sawmill for artificial forests	1966	Yes	...	...	—	110,000 c.i.f. Canada	This transaction has not yet been finalized. CORFO said that this type of equipment was available in Norway, the United States and Australia. The purchase was recommended, after study, by the Instituto Forestal, a state-owned concern.

Examples of prices paid with tied credits *(continued)*

Country or agency granting the credit	*Project*	*Particulars of purchase*	*Date on which tenders were invited*	*Were international tenders invited?*	*Lowest quotation from tied credit source*	*Lowest international tender*	*Percentage of excess cost of tied credit source*	*Quotation finally accepted and supplier country ($U.S.)*	*Remarks*
Spanish Institute of Foreign Exchange and Export Credit of the Institute of Madrid	Expansion and modernization of the fisheries industry	Three fishing vessels	1966	Yes	...	...	—	681,209 c.i.f. Spain	The order was placed with shipbuilders in Vigo, Spain, on the recommendation of the Chilean Consul in that city, the terms for the servicing of the debt being favourable. More up-to-date vessels are available in the Federal Republic of Germany at similar prices.
USAID	Expansion of the electronics industry	Machinery and equipment for the manufacture of electronic components for television receivers	1967	Yes	...	...	—	49,559 c.i.f. United States of America	This credit can only be used in the United States. The industrialist concerned said that he would have selected the same fim even if he had had a free choice. The company has an agent in New York who works for the International Commodities Export Corporation.
				B. Public sector					
USAID	Electrification plan	Purchase of 230 KW reclosers	15 February 1964	Yes	5,775	2,170 Japan	166	5,775 United States of America	Twelve companies bid for this contract. Quotations ranged from $2,170 to $5,775 and delivery deadlines from 8 to 18 months.
USAID	Electrification plan	Purchase of disc insulators	6 April 1964	Yes	8,425	6,093 Japan	38	8,425 United States of America	Four companies bid for this contract. Quotations ranged from $6,093 to $10,785 and delivery deadlines from 3 to 12 weeks. The firm selected offered the earliest delivery date.
USAID	Electrification plan	Purchase of steel cables	8 Deecmber 1964	Yes	7,205	7,005 Switzerland	3	7,205 United States of America	Four companies bid for this contract. Quotations ranged from $7.005 to $9,897.
USAID	Electrification plan	Purchase of 5/16th and 5/8th inch steel cables	1964	Yes	9,490	9,114 Belgium	4	9,490 United States of America	Nine companies bid for this contract. Quotations ranged from $9,114 to $18,695 and delivery deadlines from 2 to 5 months.
USAID	Electrification plan	Purchase of Copperweld type cables and connectors	1964	Yes	17,241	15,785 France	9	17,241 United States of America	Six companies bid for this contract. Quotations ranged from $15,785 to $18,121 and delivery deadlines from 3 to 18 weeks. The firm selected offered the earliest delivery date.

USAID	Electrification plan	Purchase of Leopold limnigraphs		No	3,120			3,283 United States of America	Two companies bid for this contract. The other United States firm submitted a bid of $3,120 but Leopold and Stevens was chosen because it is the regular supplier.
Export-Import Bank of Washington (Eximbank)	Expansion of the iron and steel industry	Machinery, equipment and spare parts	1964	No	4,491,000			4,491,000 United States of America	According to a statement by an executive officer of the CAP, the order was placed with the company's regular United States suppliers.
USAID	Electrification plan	Purchase of two Gardner Denver rotary compressors	1965	Yes	29,759	24,142 United Kingdom	23	29,759 United States of America	Four companies bid for this contract. Quotations ranged from $24,142 to $30,142 and delivery deadlines from 2 to 6 months. The firm selected offered the earliest delivery date.
USAID	Electrification plan	Purchase of Ford van	1965	Yes	10,367	8,456 United Kingdom	23	10,367 United States of America	Three companies bid for this contract. Quotations ranged from $8,456 to $15,097 and the delivery deadline was 3 months in each case.
USAID	Electrification plan	Purchase of two Diesel Caterpillar generating units		No	9,400			13,692 United States of America	There were no international tenders. Four United States firms submitted quotations ranging from $9,400 to $13,692 and delivery deadlines from 4 to 8½ months. The firm selected offered the earliest delivery date.
USAID	Electrification plan	Purchase of Standard Electric meters	1965	Yes	9,888	8,799 Netherlands	12	9,888 United States of America	A quotation was also submitted by Philips, the Netherlands firm but Standard Electric was selected because USAID credit was available.
USAID	Electrification plan	Purchase of a Caterpillar machine		No	14,981			14,981 United States of America	There were no international tenders. Two United States companies submitted bids.
USAID	Electrification plan	Purchase of mobile and portable equipment for patrols		No	75,650			84,000 United States of America	There were no international tenders. Two United States companies submitted bids. The firm selected offered an earlier delivery date.
USAID	Electrification plan	Purchase of a power grader	1965	Yes	19,360	17,475 Germany (Federal Republic of)	11	19,360 United States of America	Five companies bid for this contract. Quotations ranged from $17,475 to $21,550 and delivery deadlines from 3 to 7 weeks.
USAID	Electrification plan	Purchase of two grinding wheels, with spares	1965	Yes	1,795	1,940 United Kingdom	−7	1,795 United States of America	Four companies bid for this contract. Quotations ranged from $1,795 to $1,998 and delivery deadlines from 2 to 5 weeks.
Germany, Federal Republic of,	Sugar plan (IANSA)	Equipment for a sugar refinery	1965	Yes	1,898,807	1,940,125 Germany, Federal Republic of	−2	1,898,807 Germany, Federal Republic of	Credit was made available by Braunschweigische Maschinenbauanstalt B.M.A. Germany (Federal Republic)

Examples of prices paid with tied credits *(continued)*

Country or agency granting the credit	*Project*	*Particulars of purchase*	*Date on which tenders were invited*	*Were international tenders invited?*	*Lowest quotation from tied credit source*	*Lowest international tender*	*Percentage of excess cost of tied credit source*	*Quotation finally accepted and supplier country ($U.S.)*	*Remarks*
Eximbank	Expansion of the iron and steel industry	Machinery equipment and spare parts	1965	No	5,401,000			5,401,000 United States of America	According to a statement made by an executive officer of CAP, the order was placed with the company's regular United States supplier.
USAID	Electrification plan	Purchase of 170 55-gallon drums of insulating oil for transformers	1966	Yes	3,321	3,425 United Kingdom	—3	3,321 United States of America	Two companies bid for this contract.
USAID	Electrification plan	Purchase of automatic circuit breakers		No	4,360			4,360 United States of America	There were no international tenders. Quotations by five United States companies ranged from $4,360 to $7,800.
USAID	Electrification plan	Purchase of 51 safety helmets		No	4,512			6,278 United States of America	
USAID	Electrification plan	Purchase of 265 55-gallon drums of insulating oil	1966	Yes	5,378	4,980 United Kingdom	8	5,378 United States of America	Two companies bid for this contract. The United States firm was chosen because it is the regular supplier.
USAID	Electrification plan	Purchase of four tractors	1966	Yes	10,915	10,760 Kingdom United	1	10,915 of America United States	Two companies bid for this contract.
USAID	Electrification plan	Purchase of protective gloves		No	7,800			8,057 United States of America	Two companies bid for this contract. The other United States firm submitted a bid of $7,800 which was rejected because the quality of the goods produced by this particular firm was considered inadequate.
USAID	Electrification plan	Purchase of 250-KW and 400-KW mercury vapour lamps	1966	Yes	2,687	2,598 Switzerland	3	2,687 United States of America	Three companies bid for this contract. Quotations ranged from $2.598 to $2,787 and delivery deadlines from 3 to 6 weeks.
USAID	Electrification plan	Purchase of telegraph components	1966	Yes	2,779	2,746 Switzerland	1	2,779 United States of America	Two companies bid for this contract.
Germany (Federal Republic)	Sugar plan	Equipment for a sugar refinery	1966	Yes	8,382,531	8,284,101 Czechoslovakia	1	8,382,531 Germany, Federal Republic of	Quotations were submitted from firms in the United States, Italy, Germany (Fed. Rep.), Poland, France, United Kingdom, Spain, Czechoslovakia, Belgium, the

									Netherlands and Yugoslavia. The Government of the Federal Republic of Germany granted a loan of DM 70 million through the Kreditanstalt für Wiederaufbau. Of this amount DM 40 million, or about US $10 million, were to finance costs in foreign currency and the balance to finance costs in local currencies.
Eximbank	Expansion of the iron and steel industry	Machinery, equipment and spare parts	1966	No	3,215,000	. . .		3,215,000 United States of America	According to a statement made by an executive officer of CAP, the order was placed with the company's regular United States suppliers.
USAID	Electrification plan	Purchase of a Ford vehicle	1967	Yes	10,367	8,456 United Kingdom	23	10,367 United States of America	Three companies bid for this contract. Quotations ranged from $8,456 to $15,097 and the delivery deadline was 3 months. The Ford Company of the United States was selected because a USAID credit was available.
USAID	Electrification plan	Purchase of reclosers		No	11,500			11,500 United States of America	Two companies bid for this contract.
USAID	Electrification plan	Purchase of electrical equipment		No	29,700			29,700 United States of America	Three companies bid for this contract. Quotations ranged from $29,700 to $31,450 and delivery deadlines from 3 to 5 months.
USAID	Electrification plan	Purchase of safety belts		No	3,300			4,240 United States of America	Eight companies bid for this contract. Quotations ranged from $3,300 to $5,028.
USAID	Electrification plan	Purchase of spare parts for four locomotives	1967	Yes	24,973	23,780 Germany, Federal Republic	5	24,973 United States of America	Five companies bid for this contract. Quotations ranged from $23,780 to $25,125.
USAID	Electrification plan	Purchase of two tractors	1967	Yes	35,924	33,900 United Kingdom	6	35,924 United States of America	Two companies bid for this contract. The delivery deadline was 3 weeks in the case of the higher bid and 6 weeks for the lower bid.
Eximbank	Expansion of the iron and steel industry	Machinery, equipment and spare parts	1967	No	412,110			412,110 United States of America	According to a statement made by an executive officer of CAP, the order was placed with the Company's regular United States suppliers.

Source: Based on data from CORFO, Chile.

DOCUMENT TD/7/SUPP.8/ADD.2

Study on the excess cost of tied economic aid given to Iran in 1966/67 — by Eprime Eshag *

[Original text: English]
[13 December 1967]

Chapter I

Summary and conclusions

1. The excess cost of tied aid in 1966-1967[1] on the six projects for which quantitative estimates were made, even according to the very conservative estimates made in this paper, amounts to $1.4 million; this is equivalent to about 15 per cent of the total disbursements in respect of these projects (see annex II, table 2). But this figure no doubt exaggerates the average rate of excess cost incurred on total disbursements under tied economic assistance in 1966/67.[2] The reason for this is that the sample projects for which estimates were attempted are confined almost exclusively to the transport and harbour group of projects (section B of table 2) which according to all available indications involved a higher rate of excess cost. The rate of excess cost borne on dams and electric power projects (section A of table 2), which accounted for over 60 per cent of the total disbursements under tied aid, is likely to have been considerably smaller (see paras. 26-28 below). It is, therefore, very probable that the average rate of excess cost on total tied economic aid received in 1966/67 was of the order of 10 per cent or less.

2. The figures of excess cost shown in table 2 exclude certain costs, not easily quantifiable, which have been imposed on Iran by tying the assistance given to her. These consist of: *(a)* purchases of materials not wholly suitable to the requirements of the country; *(b)* relatively high prices paid for spare parts; *(c)* long delays in the delivery of some goods; and *(d)* administrative headaches in managing some projects (see paras. 35, 37, 38 and 41 below).

3. The burden of excess cost borne by Iran on tied aid, even if it is less than 10 per cent, can by no means be considered insignificant for a small developing country; attempts are, therefore, being made to have it reduced in the future. It is, nevertheless, probable that the amount of excess cost, measured as a percentage of the tied economic assistance received, is considerably lower for Iran than for most other developing countries. An examination of the factors which have enabled the Iranian authorities to reduce the ratio of excess cost should be of some value to both Iran and many other developing countries in formulating their policies on foreign economic assistance.

4. The major factors which have, according to this survey, contributed to a reduction of the cost of tied aid in Iran are:

(a) Success in the diversification of the source of aid, (see annex II, tables 1 and 2);

(b) Negotiation of global credit agreements, not tied to specific projects, with the Federal Republic of Germany, France and the United Kingdom (see paras. 19 and 20 below);

(c) Utilization of the country's own foreign exchange resources to finance parts of some projects.

5. The first two factors, taken together, have enabled the Iranian authorities to invite international tenders for many projects and to utilize the line of credit available to the most acceptable bidders. This has been true of the allocation of most of the contracts for dams and electric power projects (see paras. 26-28 below), and is no doubt largely responsible for the relatively low ratio of the excess cost borne on these projects mentioned in paragraph 1. These two factors have also enabled the authorities to induce competitive bidding among potential suppliers thereby reducing the cost of imports (see para. 45 below).

6. The third factor mentioned above has operated primarily in relation to the project-tied assistance received from the United States. Despite the relatively easy credit terms of the United States Agency for International Development (USAID) loans available for some projects, the Iranian authorities have chosen to resort to the country's own cash resources in order to procure certain equipment required for these projects from outside the United States at appreciably lower prices than those quoted by American businessmen (see paras. 44, 47, 50 and 51 below).

7. The extent to which a country is able to make use of some technique or other to offset the adverse effects

* This study by Mr. Eprime Eshag, Fellow of Wadham College, Oxford, has been prepared at the request of the UNCTAD secretariat. The views expressed do not necessarily reflect those of the secretariat.

[1] Throughout this paper the year 1966/67 stands for the Iranian calendar year 1345, ending on 20 March 1967.

[2] The economic aid received for industrial projects (section C of table 2) is not included in the figure of "total disbursements," since it consisted almost exclusively of financial transactions—advance payments on account of future procurements (see para. 18 below). This also explains why these projects were excluded from the discussion of "Excess cost of tied aid" in chapter IV of the paper.

of tied economic assistance on costs clearly depends on a number of political and economic factors which need not be discussed here. Generally, however, the less rigid a country's external relations, the more credit-worthy its economy and the more effective its planning machinery, the greater would be its freedom in the choice of suppliers and the lower its burden of excess costs. This means that some of the poorest developing countries, in greatest need of foreign economic assistance, are least able to avoid the excess costs of tied aid. But even countries which find themselves in a more favourable position in this respect enjoy a limited freedom of manoeuvrability in such matters. In other words, any move to untie, or to tie less rigidly, foreign economic assistance will benefit all developing countries, but especially some of those who are in greatest need of that assistance.

Chapter II

The scope of work

8. The relative economic attractiveness, or the relative " worth ", of the alternative lines of available foreign economic assistance, whether in the form of grants or loans, is determined by two sets of factors. The first set consists of the terms and conditions related to the repayment of the assistance received and the rate of interest charged on it.[3] For the sake of brevity, this set of factors is at times referred to as " crédit terms " of loans. The second set of factors concerns the cost of goods and services procured under the aid programme.

9. The present study is concerned solely with the second set of factors mentioned ; the first set of factors is taken as given. Moreover, it is confined to the " tied " bilateral public economic assistance ; it excludes private investment, suppliers' credit and economic aid received from international agencies. The term " aid " is used loosely here to include gifts as well as long-term development loans.

10. The word " tied " appended to the words " loan " and " economic aid ", signifies the presence of certain conditions in foreign aid agreements which limit either the choice of projects or the choice of suppliers of goods and services financed by the aid.[4] An " untied " or " free " loan, on the other hand, would permit the recipient country to use the proceeds of the loan for any development project and for the purchase of goods and services from any country it chooses, through international tender invitations or otherwise.

11. The primary objective of the study is to examine the effect of " tying " of loans on their efficacy in providing economic assistance. More specifically, it aims at producing a rough estimate of the additional financial charge, if any, borne by Iran under " tied " economic assistance owing to price differentials. This additional financial charge is designated as " excess cost of tied aid ". In other words, the " excess cost of tied aid " is the difference between the actual cost of goods and services imported under tied aid and the notional cost that would have been incurred for the procurement of identical, or similar, goods and services had the recipient country been free in the choice of its projects and of its suppliers. For the sake of brevity, the term " excess cost " is, at times, used to convey the meaning of the " excess cost of tied aid ".

12. The survey is also intended to throw some light on certain drawbacks of tying economic assistance which cannot easily be quantified, but which may, nevertheless, be of primary importance to the recipients of aid. These " unquantifiable " costs of tying aid could arise from the unsuitability to local conditions of certain goods and services imported under the aid programme. Such costs may also be incurred as a result of excessive delays in delivery, due, for example, to long distances and language barriers between the suppliers of goods and services and the recipient countries.

13. It is to be hoped that there will be a gradual relaxation in the tying provisions of economic assistance without a reduction in the volume of that assistance. It is further to be hoped that any reduction in the cost of aid, through a relaxation of the tying provisions of loans, is not accompanied by a parallel tightening of their credit terms—the first set of factors mentioned in paragraph 8. These factors, which play a crucial role in determining the " worth " of economic assistance, are invariably taken into account by developing countries in choosing between the alternative offers of assistance.[5] At times, as in the case of recent tender invitations in Iran, this fact is expressly brought out in tender documents, which require the bidders to state the terms and conditions of credit offered (see annex I).

14. The data presented in this paper have been collected from the officials, in particular from the technical, financial and administrative personnel, of the government agencies and public corporations quoted as sources of information. The persons concerned have co-operated wholeheartedly and have rendered every possible assistance in furthering the purpose of the survey. But despite this fact, it has not been possible to examine the subject matter as thoroughly as one would have wished within the short period of about three weeks devoted to it.

Chapter III

Source, type and terms of aid

15. Table 1, in annex II presents a broad picture of the economic assistance received by Iran in recent years.

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[3] In addition to the length of the periods of grace and amortization, these terms and conditions cover the form of repayment, i.e. whether in cash or in kind, and, if in cash, whether in internal or foreign currencies.

[4] These are two important ways of " tying " aid considered here ; other aid conditions, formal or informal, limiting the freedom of action of the recipient countries are not taken into account. For a full discussion of this and other subjects, see Jagdish Bhagwati, " The tying of aid " (document TD/7/Supp. 4), and "The costs of aid-tying to recipient countries : progress report by the secretariat of UNCTAD " (document TD/7/Supp.8), both to be found in this volume of the series.

[5] Developing countries have no special interest in the important fact that certain public loans with relatively easy credit terms do in effect play the role of an export subsidy ; this is a matter for consideration by the industrial member countries of the General Agreement on Tariffs and Trade (GATT).

The figures shown are confined to public development loans received from industrial countries and from international agencies; no account is taken of private inflow of capital and military assistance. Similarly, a loan of $17.5 million received from the International Monetary Fund (IMF) in October 1964 has been excluded from the table as it does not fall within the category of development loans.

16. An important fact which clearly emerges from table 1, is the steep rise in the volume of economic assistance received in the year 1966/67; almost all of this increase is accounted for by the growth in bilateral tied aid. This is explained by an acceleration in the pace of execution of development projects under the Third Five-Year Plan due to end in March 1968. The fact that some of the bilateral credits were likely to expire before the end of the Third Five-Year Plan could have contributed to this process of acceleration of disbursements. The loss, if any, that can be attributed to the provisions limiting the period of utilization of loans in this case is a matter of conjecture.

17. A more significant fact from the point of view of this study indicated by the table is the steady increase in the number of the countries providing economic assistance to Iran in the course of the last two years. Although during this period the share of the United States in total economic assistance (about 50 per cent) has remained almost unchanged, the number of countries accounting for the remainder has increased considerably.[6] Moreover, judging on the basis of the new loan agreements concluded in 1966 and 1967, it is quite probable that the share of non-United States sources in total inflow of development capital will grow substantially in the future. As explained below, this diversification in the source of foreign development loans has played an important part in enabling the Iranian authorities to reduce the cost of tied aid.

18. A brief description of the projects financed by tied economic aid in 1966/67 is given in annex II, table 2. It can be seen that over 85 per cent of disbursements were in respect of investment in infrastructure—sections A and B of the table. This percentage would be even higher in terms of the actual outlays on goods and services, since the disbursement of about $8 million from the USSR loans, shown in section C of the table, was almost exclusively a financial transaction. Strictly, this item is not relevant to the present study of the excess cost of tied aid in Iran during 1966/67. It is included in the table merely to indicate the future trend of disbursements—a shift from infrastructure to industry and the diversification of the source of economic assistance mentioned above.

19. Although all the loans mentioned in table 2 can generally be considered as tied, there are significant differences between the tying requirements of the various donor countries. At one extreme, the loans granted by the United States and the USSR (lines 7 to 17) are not only tied to specific projects, but are also tied to the financing of goods and services originating in the respective donor country. At the other extreme, the global credit of $50 million granted to Iran by the Federal Republic of Germany, from which the projects specified in lines 1 and 2 of the table were financed, is made available for investment in any project deemed necessary for the general improvement of the Iranian economy. The only restrictive provision of the two loan agreements A. L. 124 and A. L. 284, concluded under this credit, is that the proceeds of the loans should not be used for the purchase of goods and services from mainland China, from the socialist countries of Eastern Europe, and from Yugoslavia.

20. The global credits of $60.8 million from France and $11.2 million from the United Kingdom, through which the projects mentioned in lines 3 to 6 of the table were financed, are both tied to the import of goods and services from the respective donor country. But neither of the two credits is tied to specific projects. The United Kingdom credit is made available for financing development projects included in the Third Five-Year Plan of Iran,[7] for the import of capital goods and for the employment of United Kingdom personnel. The French credit, which was initially made for a number of broadly defined projects and only for two years (1964 and 1965), was in practice made available for any development project chosen by a mixed Franco-Iranian commission; its two-year validity period was also extended.

21. The availability of loans not tied to specific projects, from the three Western European countries has, as shown below, enabled the Iranian Government to reduce the cost of tied aid in many instances. It has extended the area within which tender invitations have been circulated beyond the individual donor country, thereby giving the authorities a larger freedom in the choice of the project contractors. This is particularly true of the credit granted by the Federal Republic of Germany with its limited tying requirements.

22. The main advantage of the project-tied loans granted by the United States and the USSR is their relatively easy credit terms shown in columns 3 to 5 of table 2. In the case of the former country, this is true only of the USAID loans and not of the loans granted by the Export-Import Bank of Washington (Eximbank). The Iranian authorities have naturally taken these terms into account in estimating the "worth" of the loans in question. A further feature of the USSR loans which has added to their relative attractiveness is that they are generally repayable in kind. In particular, the loans specified in lines 16 and 17 of the table are expected to be settled by the export of gas from the Iranian oil fields, which has until now had little or no economic value.

[6] The share of the United States in total economic aid would have been substantially lower in 1966/67 than in the preceding two years but for the fortuitous fact that disbursements on two major projects (lines (8) and (14) of table 2), accounting for over two thirds of the total United States assistance, were made in that year.

[7] The contracts under which payments are made have to be concluded before 19 September 1967; the period covered by the Plan ends on 20 March 1968.

Chapter IV

Excess cost of tied aid

23. Except in a few cases, it has unfortunately not been possible to make an estimate for the excess cost of tied aid as defined in paragraph 11 above. This is partly because of the lack of the necessary data and partly on account of the limited time made available for this survey. Even in the cases where it was possible to examine this question in some detail, estimates of the excess cost are no more than rough approximations. The figures shown in columns 7 and 8 of table 2 should, therefore, be treated as very rough, but rather cautious and conservative, estimates of the excess cost of tied aid in 1966/67.

A. *Dams and electric power projects*[8]

24. Most of the projects listed under this heading in table 2 were subject to some form of national or international invitations for tenders. The resort to international invitations for tenders was made possible by the availability of global credits, not tied to specific projects, from the three western European countries mentioned. This has enabled the Iranian authorities to reduce, if not wholly to eliminate, the burden of the excess cost of aid in many important instances.

25. Given the credit terms of aid, the wider the area over which invitations for tenders for a project are circulated, the lower is likely to be the excess cost borne on that project. Since, however, the credit terms of aid from various sources have not been identical, the choice of contractors has not always been confined to the lowest bidders (see para. 13 above). This being the case, it would have been necessary to compare the bids received under different credit terms in order to ascertain the amount, if any, of the excess cost involved. But, unfortunately it has not been possible to do so within the time available, and what is said on these projects does little more than give a broad hint of the order of magnitude of the excess cost.

26. The contractors of the projects mentioned in lines 1 and 2 of the table were chosen through international tender invitations. Although disbursements on both these two projects were financed by loans received from the Federal Republic of Germany, the winner of the tender for project 1 was a non-Federal Republic Western European firm, this being allowed by the terms and conditions of the loans (see para. 19 above). Since the credit terms of loans from the Federal Republic are only moderately easier than those available from the other major Western European countries, it can be assumed that the excess cost, if any, borne in these two cases would not be of significant proportion.

27. Similar considerations apply to the disbursement of $2.3 million in 1966/67 on various projects for electrical equipment and installations, (see line 6 of table 2). These projects, amounting to $9.5 million, were subject to an international tender invitation which was won by British suppliers offering the credit terms of the global credit of $11.2 million granted to Iran by the United Kingdom Government.

28. The construction of projects 3, 4 and 5, financed from the global credit of $60.8 million granted by the French Government, was entrusted to French contractors without a tender invitation. The reason given for this was that project 3 consisted of an extension of the electric generating power of the Empress Farah Dam with generators similar to those supplied by the contractor in earlier years through an international tender invitation. Similar considerations have guided the choice of the contractor for the extension of power network in Teheran (project 4). The reason given for choosing the contractors of project 5 was that their earlier work in Iran was found very satisfactory; it is not possible to ascertain the effect of this decision on the cost of aid.

29. The USAID loan H-016 for project 7 was for $2.4 million of which only about $800,000 was utilized for the first phase of the work and the balance was allowed to lapse. The reason given for this was a disagreement with the USAID authorities as to the disbursements on the second phase of the project. The figure of 30 per cent is considered a conservative estimate of the excess cost of aid in this case. It is based on a comparison of the scale of salaries, fees and allowances paid to the United States technical and administrative staff with the scale of payments made to Western European personnel of similar qualifications and functions. (See paras. 36 and 54 below.)

30. The choice of contractors for the Farah-Abad power plant, constructed under a " turn-key " arrangement, was made through an invitation for tenders circulated among the United States suppliers. The tender had invited bids for smaller-size turbines (75 MW), but eventually an offer to supply larger-size turbines of 82.5 MW *ex stock* was accepted. Some technical persons interviewed considered that, had the tender invitation been international, savings of 10 per cent or more could have been made in the construction of the plant. Others were of the opinion that as much as 20 per cent could have been saved, but there might have been a considerable delay in the delivery of the turbines and in the completion of the project. Owing to the complex nature of these problems and the absence of concrete data on the prices of the alternative offers of supply, no attempt has been made to estimate the excess cost of aid on this project. A further reason for this was the large weight of the disbursements on the projects in the total economic assistance received during 1966/67; a relatively small error in the estimate of the rate of excess cost for the project would, by its disproportionately big effect on the total figure of excess cost, have seriously distorted the whole picture of the excess cost of foreign aid borne by the country.

31. The two dams mentioned in project 9 were constructed by the USSR on the frontier river of Aras; the cost of the project and the facilities provided by it are to be shared on an equal basis. The credit advanced to Iran by the USSR, to cover the former's share of the cost, is repayable in rials which are to be used primarily

[8] The sources of information for this section of the paper are the Plan Organization and the Ministry of Water and Electricity.

for the purchase of goods and services in Iran, but which may, at the request of the USSR, be exchanged into a convertible currency. No attempt has been made to evaluate the amount of excess cost, if any, relevant to this project.

B. *Transport and harbour projects*[9]

32. It can be seen from table 2 that economic assistance for this group of projects, unlike that for dams and electric plants, has come exclusively from the United States. As mentioned in paragraph 19 above, these loans are not only tied to the financing of goods and services originating in America, but are also tied to the specific projects mentioned. As it was possible to study in some depth the disbursements made on most of these projects, this section provides a number of interesting illustrations of the excess cost involved in this type of tied economic assistance and of the techniques used by the Iranian authorities for avoiding such costs.

Project 10.—Road maintenance equipment

33. The bulk of the road maintenance and railway equipment purchased by the Iranian Ministry of Roads is imported from the United States. The primary reason for this is that the major components of this category of equipment, currently in use in Iran, are of United States designs and models. These items, which include diesel locomotives, bulldozers, tractors, trucks etc., have for a period of over ten years been imported from the United States under its successive aid programmes. In the circumstances, it is almost imperative that most of the orders for replacements and spare parts should be placed with the United States manufacturers.

34. A further reason which goes some way to explain why the United States is the main source of supply of road maintenance equipment, is the important part played in the choice of orders for this equipment by the United States technical personnel—engineers, equipment specialists, etc.—employed by the Ministry of Roads. The goods are ordered for Iran by the United States Bureau of Public Roads in accordance with the instructions received from the Iranian Ministry of Roads. The Ministry is, in turn, advised on its purchases by procurement commissions on which sit United States personnel; their opinions are treated with some respect in such matters. These people, who are naturally more familiar with United States equipment, cannot but have a general preference for it even in those cases where the required goods can be procured from other countries.

35. Although the road maintenance equipment imported from the United States is generally of a very high quality, some of it is found to be unsuitable to the needs of the Iranian Department of Road Maintenance. An important example mentioned was a particular variety of larger size tractors ordered by one of the procurement commissions; these are found unnecessarily big for the normal requirements of the Department. Moreover, some of the equipment purchased is not wholly suited to local conditions. This is true, for example, of the "turbo-supercharger", an accessory attached to certain of the larger-size tractors; its purchase is obligatory. It is expensive and has a complex mechanism which cannot easily be handled and maintained by the Department's workers.

36. A further important factor which has raised the cost of economic assistance provided for this project is the relatively high rate of pay of the United States technical personnel employed by the Ministry of Roads. It was possible to examine in some detail the scale of salaries and allowances paid in dollars and in rials to the various grades of engineers and specialists now in the employment of the Ministry. It is clear that this scale is at least some 30-40 per cent higher than the scale of payments made to technicians of similar qualifications from other industrial countries working in Iran. The payments made to United States personnel in dollars alone have absorbed about 15 per cent of total dollar disbursements on the project up to date.[10] Bearing in mind this fact and the points noted in the preceding paragraph, the estimate of the excess cost of aid (5 per cent) shown in table 2 should be regarded as a rather conservative one.

Project 11. — Railroad equipment

37. The disbursement of about $1.5 million on this project in 1966/67 consisted almost exclusively of payments for spare parts and replacements imported by the Iranian State Railways; the chief reason for buying the bulk of these goods from the United States was explained in paragraph 33. Alternative price quotations were not available for the particular articles purchased in that year because most of them were not of specifications produced in other countries. But a comparison of price quotations by two United States suppliers and a supplier from another country for a sample of three standard-type spare parts disclosed that the United States prices were in one case about 35 per cent and in the other two almost 80 per cent higher. It was the opinion of the officials interviewed that, on average, the United States prices for spare parts on a c.i.f. basis are at least 30 per cent higher than those of the other sources of supply; this figure has been used as an estimate of the excess cost applicable to the disbursements made on the project in 1966/67.

38. Another cost mentioned in relation to the railroad spare parts financed by the United States aid is the relatively long delay in deliveries as compared with imports from most other industrial countries. This cost, which no doubt is also borne in the purchase of spare parts and replacements for road maintenance equipment (project 10), cannot easily be quantified and has not been taken into account. Theoretically, it would be equal to the cost incurred in carrying the extra volume of stocks of spare parts required for the purpose of avoiding prolonged interruptions in railway and road maintenance operations.

[9] The sources of information for this section of the paper are: the Ports and Shipping Administration; the Ministry of Roads, Department of Road Maintenance; Ministry of Roads, Iranian State Railways and the Iranian National Airline Corporation.

[10] The number of the United States technical personnel has, however, declined in recent years—from over thirty-five, some time ago, to about twelve.

Project 12. — Construction of a section of Central Treaty Organization (CENTO) Railway

39. The USAID loan K-001 of $7.8 million was granted for the construction of an 80 km section of the CENTO Railways, from Karah-Tapeh in Iran to the Iranian-Turkish frontier town of Kotour (Razi). Despite the relatively small disbursement involved, the project provides some interesting examples of the excess costs of tied aid and of the techniques used by the Iranian authorities to avoid some of these costs.

40. In accordance with the general USAID practice, purchases financed by this loan had to be made through tender invitations in the United States and were to be confined to the requirements of the project. The condition of tender invitations in this case could have resulted in the purchase of certain types of equipment of different models and specifications from the equipment currently in use on the rest of the railway. At the same time, the goods bought through the loan could not be used outside the 80 km section of the railway mentioned.

41. The above conditions of the loans were likely to cause serious difficulties in terms of the operation and maintenance of the equipment bought. A number of workers, whose skills would have been largely specialized to a small stretch of the railway, would have had to be trained to run the new equipment. It was only after strenuous and persistent efforts by the Iranian State Railways that USAID was prepared to relax its requirement of tender invitations. The prolonged correspondence which ensued on this subject is one reason for a slow rate of utilization of the loan; total disbursements between the end of May 1964, when the loan agreement was concluded, and March 1967 consisted of the $108,000 spent in 1966/67.

42. Another factor which partly accounts for a slow rate of utilization of this loan is the relatively high prices quoted in the United States for some of the materials required. Despite the very attractive credit terms of the loan, the Iranian authorities have, in some instances, preferred to resort to their own foreign exchange resources for the purchase of certain goods rather than to draw on the USAID credit. The two clear examples of appreciable price differentials quoted by Iranian State Railways, relate to rails and to lubricators; in both cases the requirements of the project were financed by the country's own cash resources.

43. The following table compares the price quotations for rails of two United States manufacturers with those of two other countries received about mid-January 1967 in response to an invitation for tenders:

Cost and freight price quotations for rails[a] in mid-June 1967
($US per ton)

United States	
Firm I	167.19
Firm II	160.77
Country A	114.00
Country B	110.00

Source: Ministry of Roads, Iranian State Railways.

[a] U.33 heavy type rails, weighing 46.303 kg per linear metre.

44. It can be seen that even the lower bid from the United States was about 40 per cent higher than the bid from country A and some 45 per cent higher than the bid from country B. In the circumstances, the Iranian authorities used their own cash resources to buy 32,130 tons of rail from country B; of this, about 8,000 tons were allocated to project 12. The switch from USAID loan to the country's own cash resources thus resulted in a saving of over $400,000 in the cost of this project—8,000 tons at $50.77 per ton.[11]

45. Moreover, the Iranian State Railways were able to induce some competitive bidding on the part of country A in subsequent negotiations, by disclosing to it the bid received from country B. In exchange for a purchase of 26,000 tons of rails at $113.00 per ton, c. and f., from country A, the latter agreed to reduce the price of " steel sleepers " by over $10.00 per ton on a shipment of 10,000 tons.[12] It can be seen that the extra cost of rail, as compared with the bid of country B (26,000 tons at $3 per ton) was more than offset by the reduction of the price of " steel sleepers ".

46. The second example of shifting the source of supply from the United States to another country related to the procurement of " C-4, Lubricators " for project 12.

The terms of the two offers received for the supply of 200 lubricators were as follows:

(a) *From firm III in country C on 24 November 1965*
Price: $162 per lubricator, c. and f.
Payment: Cash against irrevocable letter of credit.
Shipment: twelve to sixteen weeks after receipt of letter of credit.

(b) *From firm IV in the United States on 14 February 1966*
Price: $499 per lubricator, c.i.f.
Payment: Cash against irrevocable letter of credit.
Shipment: twenty-six months after receipt of letter of credit.

It can be seen that, even if it were assumed that the insurance charge from country C were as much as 2 per cent of the c. and f. price, the price quotation received from that country would still be less than one third of that obtained from the United States,[13] moreover, the delivery period was much shorter in the case of country C.

47. Having closely examined the two offers of supply, the Iranian authorities chose to use their own cash resources to order the 200 lubricators in country C on 1 March 1966. In this way, a saving of over $66,000 was made on a small transaction of about $33,600 representing the final price at which 200 lubricators were invoiced.

[11] $50.77 is the difference between the lower bid received from the United States ($160.77) and the bid of country B ($110.00).

[12] The " steel sleepers " were now bought at $112 per ton; the price charged in the past had ranged from $122 to $126 per ton.

[13] In view of the wide disparity between the two sets of price quotations, these were verified by a close scrutiny of the correspondence exchanged between the suppliers and the Iranian State Railways. The railway personnel were firm in their opinion that the lubricators offered for sale by the two suppliers were of an identical model.

48. The disbursement of $108,000 made on project 12 in 1966/67 consists almost exclusively of the salaries, fees and allowances paid to the United States consultants and engineers engaged on the project. It is assumed that the excess cost involved in this case is of the same order of magnitude as that applicable to the pay of the United States technical personnel employed by the Ministry of Roads (see para. 36 above). The figure of 30 per cent is, therefore, considered a conservative estimate of the excess cost borne on the project in 1966/67.

Project 13. — Bandar Abbas harbour

49. The tender invitation for this project, circulated among United States firms, was won by three contractors which had formed a joint venture for the purpose. The whole Bandar Abbas harbour project consists of four parts, or "lots" as they are called, made up as follows:

Lot 1—Commercial section of the harbour;

Lot 2—Floating equipment;

Lots 3 and 4—Naval section of the harbour, and extension of harbour facilities.

50. It was initially intended to finance the construction of lots 1 and 2 from the USAID loan H-017 granted for the project. But price quotations from the United States contractors for the equipment included in lot 2 were, as shown below, found to be considerably higher than certain quotations received from other countries. It was, therefore, decided to buy this equipment, with the country's own resources, from those other countries, despite the very attractive credit terms of the USAID loan. A similar decision was taken on the procurement of some of the equipment required for lot 1. As a result, it is expected that only about $12 million of the total loan of $15 million granted for the project will in the end be utilized.

51. Lot 2 (floating equipment) consisted of the provision of two tugboats and a pontoon barge for the harbour. The following table shows the price bids received from the United States and from other sources, through an international tender invitation, for the supply of these goods and for a major piece of equipment required for lot 1.

The wide disparity between the price bids from the United States and from the other countries mentioned explains the decision to place the orders in the latter. It can be seen that this decision, which involved the use of some $1.4 million of the country's own cash resources on the project, resulted in a saving of almost $1 million in its cost of construction.

Selected equipment for Bandar Abbas Harbour

(Price bids, in $US thousand)

	United States contractors	*Other countries*	
		Bid[a]	*From*
Lot 2			
2,500 H.P. tugboats	543	382	Country D
1 pontoon barge	907	496	Country E
Total, Lot 2	1,450	878	
Lot 1			
1 overloading installation . . .	851	485	Country E
Total, Lots 2 and 1	2,301	1,363	

Source: Ports and Shipping Administration.

[a] Lowest bid received.

52. Two estimates were received on the excess cost of goods and services imported from the United States for the project. The first, which was based on a general impression rather than detailed calculations, considered a figure of 30-35 per cent a reasonable estimate of the excess cost. The second estimate was derived from a comparison of prices charged by the contractors for a sample of materials and of services with European prices for similar goods and services; the figure obtained was 15-20 per cent. In both estimates a large weight was attached to the relatively high scale of salaries and allowances paid to the United States personnel working on the project. The figure of 15 per cent shown in table 2 should be considered as a fairly conservative estimate of the excess cost of aid on this project.[14]

Projects 14 and 15. — Iranian National Airline Corporation

53. Project 14 consisted of the purchase of two jet aircraft for the Iranian National Airline Corporation. The decision to buy the particular type of aircraft involved was determined primarily by the transportation needs of the Corporation; it was not influenced by the credit terms of the Eximbank loan which are, in any case, relatively hard. It has not been possible to compare the prices charged to Iran for these aircraft with those charged to other buyers at that time, but there is no ground to suspect that these prices are not similar.

54. The disbursement on project 15 represents payments to United States personnel for management, technical and training services rendered to the Iranian National Airline Corporation. It was possible to examine the scale of salaries and allowances paid to the United States personnel and to compare this, in some instances, with the pay of the European experts and specialists of similar qualifications working abroad. There is little doubt that the figure of 30 per cent is a very conservative estimate of the excess cost borne in this case.

[14] It should be emphasized that "excess costs" on a project do not necessarily produce "excess profits" for the contractors. In this case, a senior employee of the contractors forecast a substantial loss for his firm on the project; this may well prove to be correct.

ANNEXES

Annex I[a]

CREDIT PAYMENT CONDITIONS

The Ministry would prefer to have a loan, governmental or private, proposed by the bidder, so that it can be applied to the items contracted.

A bid incorporating terms for financing would therefore have priority over a cash bid.

The following table is provided for use by bidders offering terms for financing:

[a] Extract from Imperial Government of Iran, Ministry of Water and Power, Power Division. *Supply of Underground Cables, Bare Conductors and Accessories, Project No. 050-15, Tender Documents, February 1967.*

Credit Payment Conditions

No.	*Description*	*This part to be filled out by the bidder*
1.	Type of loan (governmental or supplier)	
2.	Duration of loan: (1) Due date of the first principal payment from the date of the contract. (2) Due date of the first interest payment from the date of the contract. (3) Date from which interest is charged (in relation to the exact date of the contract). (4) Number and duration of instalments.	
3.	Interest pertaining to the loan.	
4.	Costs and expenditures: (1) Costs of transfer through the bank. (2) Costs of services provided by the bank. (3) Costs of insurance provided in the country submitting the bid to secure the amount financed. (4) Other expenses connected with export promotion, costs of other additional insurance, and so forth. (5) The effect of variation in the rate of cost of services when there is a lengthy period involved prior to the signing of the contract.	
5.	Transfer conditions of the promissory notes (considered only when this type of payment applies): (1) Conditions the promissory notes covering the principal must comply with. (2) Conditions the promissory notes covering the interest must comply with. (3) Relative due dates of the promissory notes covering the principal and the interest respectively.	
6.	Miscellaneous conditions: (1) Whether the loan of the original country submitting the bid can be extended to cover products not manufactured by the original country, yet included in the proposal. (2) Various charges arising from the fact that the amount of loan, tentatively approved and decided upon previously, is not put to use.	

Annex II

TABLE 1

External public economic assistance in the years 1964/65 to 1966/67
(Disbursements, in $US thousand)

Source	*1964-1965* [a]	*1965-1966* [b]	*1966-1967* [c]
I. *Tied loans*	*15,256*	*22,653*	*56,709*
Federal Republic of Germany [d]	5,996	4,199	8,533
France	—	—	3,413
United Kingdom	—	—	2,338
United States	9,260	17,579 [e]	32,739
USSR	—	875	9,686
II. *Free loans* (International Bank for Reconstruction and Development)	5,330	*7,009*	*7,671*
TOTAL (I + II)	20,586	29,662	64,380

Sources: Central Bank of Iran and Plan Organization.

[a] Calendar year ending 21 March 1965.

[b] Calendar year ending 20 March 1966.

[c] Calendar year ending 20 March 1967.

[d] "Tied" only to the extent that no purchases are permitted from mainland China, from the socialist countries of Eastern Europe and from Yugoslavia.

[e] Includes $10.3 million assistance under title IV of Public Law 480 for the purchase of wheat and maize.

TABLE 2

Tied economic assistance and its cost in 1966/67 [a]

($US thousand)

Source of aid	Contract	Projects	Total loan	Date o loan	Terms of loan: Rate of interest per annum	Terms of loan: Repayment period (in years): Grace period	Terms of loan: Repayment period (in years): Amortization	Disbursement	Excess cost of aid: As percentage of disbursement	Excess cost of aid: $US thousand (rounded to "0")
			1	2	3	4	5	6	7	8=6×7
		A. *Dams and electric power*						*29,718*		*10*
1. Fed. Rep. of Germany	No. A.L.124	Irrigation network for the Empress Farah (Sefid-Rood) dam and Guilan Electricity	18,250 [b]	18.12.63	3¼	4 5/6	9½	4,771	...	...
2. Fed. Rep. of Germany	No. A.L.284	Manjil — Teheran power line	5,875 [b]	21.4.66	4	3 3/8	11½	3,762	...	...
3. France	No. 1515	Three hydro-electric generators for the Empress Farah (Sefid-Rood) dam	2,415 [c]	1966	5	½	10	725	...	...
4. France	—	Sundry equipment for Teheran power network	1,169 [c]	1966	5	½	10	1,169	...	...
5. France	—	Shah Abbas Great Dam	14,584 [c]	1966	5	½	10	1,519	...	...
6. United Kingdom	—	Sundry projects for electrical equipment and installations in Teheran and provinces	9,496 [d]	1966	6	5	15	2,338	...	...
7. USAID	No. H-016	Preparation of master electrification plans	799	26.6.63	¾	5	25	50	30	10
8. Eximbank	No. 2238	Power plant (with two 82.5 MW turbines) for Farah-Abad, Teheran	20,000	5.11.65	5½	3¾	15	13,768	...	...
9. USSR	No. 1-9342	Two dams on Aras River and related installations	38,500	27.7.63	3 3/5	—	12	1,616	...	...
		B. *Transport and harbour equipment*						*18,921*		*1,420*
10. Eximbank	No. 2131	Road maintenance and technical services	4,500	25.11.64	5½	1½	6½	2,552	5	130
11. Eximbank	No. 2177	Railroad equipment	4,200	25.11.64	5½	1½	6½	1,469	30	440
12. USAID	No. K-001	Construction of a section of CENTO railway	7,840	31.5.64	3½	5	30	108	30	30
13. USAID	No. H-017	Bandar Abbas harbour	15,000	26.6.63	3	7	23	4,599	15	690
14. Eximbank	No. 2246	Two jet aircraft	9,760	26.2.66	5½	1	6½	9,760	...	...
15. USAID	No. H-022	Management, technical and training services for Iranian National Airline Corporation	1,500	1.12.64	3½	3	17	433	30	130
		C. *Industry*						*8,070*		...
16. USSR	No. 8000	Steel plant and related installations	154,000 [e]	13.1.66	2½	½	12	8,022	...	...
17. USSR	No. 3675	Machine manufacturing plant in Arak	38,500 [e]	13.1.66	2½	½	12	48	...	...
		TOTAL (A+B+C)						*56,709*		*1,430* [f]

Sources: The Central Bank of Iran, the Plan Organization and Plan Organization, *The Status of Loans and External Credits of the Imperial Government of Iran*, from September 1955 to 20 March 1967, and copies of loan agreements.

[a] Year ending 20 March 1967.

[b] Part of the global credit of $50 million (DM 200 million) granted on 15.8.61.

[c] Part of the global credit of $60,8 million (Fr.fr. 300 million) granted on13.12.63.

[d] Part of the global credit of $11.2 million (£4 million) granted on 19.9.64.

[e] Part of the global credit of $286 million (Roubles 260 million) granted on 13.1.66 for the construction of a stele plant, machine manufacturing factory and gas pipes. Conversion rate in column 1 is rounded to; Roubles 1 = $1.1.

[f] The sum of the six items stated only.

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Study of tied economic aid given to Tunisia in 1965 — by Eprime Eshag*

[Original text: English]
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CONTENTS

Chapter I

Scope of the study

1. In evaluating the real value or worth of foreign economic assistance, a developing country has to take into account *(a)* the terms and conditions related to the repayment of the assistance received, including the rate of interest charged on it—the "credit terms" of aid[1] and *(b)* the prices charged for goods and services financed by the aid programme. This study is concerned solely with *(b)*; the credit terms of loans are taken as given. Moreover, it is confined to tied public economic development aid. It excludes private investment, suppliers' credit and economic aid received from the International Monetary Fund (IMF) which does not fall within the category of development aid.

2. The word "tied", appended to the words "loan" and "economic aid", signifies the presence of certain conditions in foreign aid agreements which limit either the choice of projects or the choice of suppliers of goods and services financed by the aid.[2] An "untied" or "free" loan, on the other hand, would permit the recipient country to use the proceeds of the loan for any development project and for the purchase of goods and services from any country it chooses, through international tender invitations or otherwise.

3. The primary objective of this study is to examine the effect of tying of loans on their efficacy in providing economic assistance. More specifically, it aims at producing a rough estimate of the additional financial charge, if any, borne by Tunisia in 1965 under tied economic assistance owing to price differentials. This additional financial charge is designated as the "excess cost of tied aid". In other words, the excess cost of tied aid is the difference between the actual cost of goods and services imported under tied aid and the notional cost that would have been incurred for the procurement of identical, or

* This study by Mr. Eprime Eshag, Fellow of Wadham College, Oxford, has been prepared at the request of the UNCTAD secretariat. The views expressed do not necessarily reflect those of the secretariat.

[1] In addition to the length of the period of grace and of amortization, these terms, which for convenience are referred to as "credit terms" of aid, cover the form of repayment, i.e., whether in cash or in kind, and, if in cash, whether in internal or foreign currencies.

[2] These are the two important ways of tying aid considered here; other aid conditions, formal or informal, limiting the freedom of action of a recipient country are not taken into account. For a full discussion of this and other subjects, see Jagdish Bhagwati, "The tying of aid" (document TD/7/Supp.4) and "The costs of aid-tying to recipient countries: progress report by the of secretariat of UNCTAD" (document TD/7/Supp.8), both to be found in this volume of the series.

similar, goods and services had the recipient country been free in the choice of its projects and of its suppliers. For the sake of brevity, the term "excess cost" is, at times, used to convey the meaning of the "excess cost of tied aid".

4. The study is also intended to throw some light on certain drawbacks of tying economic assistance which cannot easily be quantified, but which may, nevertheless, be of primary importance to recipient countries. These unquantifiable costs of tying aid could arise from the unsuitability of certain goods and services imported under the aid programme to local conditions. Such costs may also be incurred as a result of excessive delays in delivery, due, for example, to long distances and language barriers between the suppliers of goods and services and the recipient countries.

5. The estimates of excess costs are confined to the tied bilateral aid received from the United States which accounts for about one half of the total tied aid given to Tunisia in 1965 (see annex table 1). It has not been possible to do more than collect some general information on non-United States economic assistance. This is, of course, regrettable, but a thorough examination of the cost of non-United States aid would have entailed more elaborate preliminary preparations and considerably more time than the three weeks devoted to this study.

6. The Secretariat d'Etat au Plan et à l'économie nationale has served as the main source for general information on the origin and type of aid and has also arranged the necessary contacts with government departments, public enterprises and private businessmen. The detailed information on prices and costs has been obtained directly from the records and invoices of the Division du commerce and of private importers, and from various interviews with the management and technical staff of the public enterprises and of the private import houses quoted as the source.

Chapter II

Source, type and terms of aid

7. Table 1 gives in summary form a breakdown of the foreign public economic assistance given to Tunisia by source and by major categories in 1965. It can be seen that of the total aid less than 30 per cent was wholly free or untied; over 35 per cent was in the form of Public Law 480 and technical assistance and a similar percentage in the form of tied aid. The United States alone accounted for about one half of the total and of the tied economic assistance granted to the country.[3] The next major source of bilateral aid was Western Europe followed by North Africa and the Middle East combined.

[3] If the project-tied aid received from Kuwait and from the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) (sections III and V of the table) were excluded from the category of tied aid, the United States would account for 60 per cent of total tied aid (see para. 16 below).

A. United States aid

Public Law—$23.6 million

8. The particulars of the commodities shipped to Tunisia under Public Law 480 are shown in table 2. This is the gross value of shipments; no deduction is made in respect of the use of the counterpart funds by the United States Government discussed below. Moreover, as indicated in the table, part of the shipments was utilized for welfare purposes and had little effect on the investment funds of the country.

9. The f.o.b. value of shipments is estimated at world market prices. All shipments made under titles II and III were made in United States flag vessels, the United States Government bearing the full cost of transport. For commodity deliveries under title I, the Tunisian Government paid the United States Agency for International Development (USAID) in dinars the f.o.b. value of goods plus standard non-United States freight charges; at least 50 per cent (in weight) of shipments had to be made in United States flag vessels.

10. The shipments made under title II and title III of Public Law 480 represent grants to the Government of Tunisia and to private agencies respectively. The terms applicable to the sale proceeds of shipments made under title I are specified in two sales agreements: *(a)* sales agreement No. 4, dated 7 April 1964, which provides 10 per cent for United States use, 70 per cent for 104*(g)* loans to the Government of Tunisia repayable in dinars to the United States, and 20 per cent for Cooley loans under 104*(e)* to private United States investors in Tunisia; and *(b)* sales agreement No. 5, dated 17 February 1965, which provides 20 per cent for United States use, 70 per cent for loans under 104*(g)* and 10 per cent for Cooley loans under 104*(e)*.[4] As a result of the application of the above two agreements, the sales proceeds of the shipments made under title I were apportioned as follows in 1965:

	($US thousand)
United States Government use	2,635
Loans to the Tunisian Government 104 (g)	9,533
Cooley loans 104 (e)	1,427
Total: f.o.b. value, per table 2	13,595

Source: Secrétariat d'Etat au Plan et à l'économie nationale, Tunis.

Project assistance—$11.0 million

11. The particulars of the economic aid tied to projects is given in table 8; "A" loans are repayable in local currency and "H" loans in dollars. Of the two series "A" and "H" shown in the table, only the terms of the two loans (loans A-007 and A-008) advanced to the banks, require additional explanation. Loan A-007 to the Banque nationale agricole was tied to private imports of equipment by farmers from the United States and

[4] 104*(g)* and 104*(e)* refer to the appropriate sections of Public Law 280; since 1967, 104*(g)* has become 104 *(f)*.

loan A-008 was tied to private imports by industry from the United States. Formally, in the case of both loans, individual imports of up to $100,000 from countries other than the United States were permitted, but in practice such imports were discouraged by USAID.

12. Regarding item 10 in table 8—the purchase of diesel locomotives—85 per cent of this loan was provided by the Export-Import Bank of Washington (Eximbank) and 15 per cent by the suppliers of locomotives. Eximbank's share of the loan is repayable in twelve years and carries an interest of 5 1/2 per cent per annum on the outstanding balance, while the suppliers' share of credit is repayable in eight years (in half-yearly instalments) and carries an interest of 5 per cent per annum on the outstanding balance.

Commodity (programme) aid—$17.6 million

13. Of the total disbursements of $17.6 million under commodity-loan agreements, goods to the value of $8.3 million were shipped from outside the United States under barter agreements discussed below. The balance of $9.3 million represents the c.i.f. value of commodities imported from the United States; details of these goods are given in table 5. The four loans (H-011, H-014, H-019 and H-024) used for financing the shipment of these commodities in 1965 are repayable in dollars and in forty years with a grace period of ten years.[5] But, as shown below, the rates of interest payable on these loans indicate some hardening of the terms in respect of the more recent loans:

Rate of interest per annum

Loan No.	During amortization (percentage)	During grace period (percentage)
H-011	¾	¾
H-014	¾	¾
H-019	2	¾
H-024	2½	1

B. Non-United States aid

14. Particulars, including the terms, of economic aid received from non-United States sources, are given in tables 3 and 4. It can be seen that, despite the hardening of the terms of loans noted above, the USAID loans remain considerably easier than those received from other countries; this is not true of the Eximbank loan mentioned in paragraph 12. The loans from the Eastern European countries (table 4, section B), which are repayable in goods, have relatively easier credit terms than those granted by most other European countries.

15. In addition to the information provided in tables 3 and 4, it may be of interest to note that the French loans No. 3 and No. 4 (table 3, line 2) were used partly for the import of goods and services fro mFrance and partly to finance the local dinar expenditure on the projects. The two loans were advanced to El Fouladh for the construction of a steel factory, etc., the Société générale des industries cotonnières and the Société générale de l'industrie de laine for textile factories, and the Société tunisienne de verre for a glass factory. These projects were subject to international tender invitations, and French businessmen won the contracts. One could, therefore, assume that the excess cost of aid, if any, on the $6.5 million spent on these projects in 1965 is unlikely to be significant. The assistance of about $15 million in the form of a loan and a grant by Ente Nazionale Idrocarburi (ENI) (table 3, line 6) was made in consideration of the exploration rights for petroleum granted by the Government of Tunisia to ENI.

16. An important point to be noted in connexion with the loans classified as non-project assistance in table 3 is that, although these loans are officially untied, it was not possible to verify that, in practice, the Tunisian authorities were not expected to import at least part of the goods financed by the loans from the donor country (see also para. 11 above). On the other hand, it is clear that the two loans received from Kuwait (table 4, section A), although made for specific projects, are by no means tied to the import of goods and services from that country. The loan of $1.7 million to the Office de mise en valeur de la vallée de la Majerta was used for the development of the Majerta valley while the loan of $2.7 million to the Société tunisienne de l'électricité et du gaz was used for the construction of a plant for power generation. In this respect the aid received from Kuwait falls in the same category as that granted by the international organizations specified in section V of table 1.

Chapter III

Excess cost of United States economic aid

A. Methodology

17. In calculating the cost of United States aid, the individual estimates are, wherever possible, made in two separate ways which for the sake of brevity may be designated as the "macro" and "micro" approach. Generally, the two approaches produced reasonably similar results; in cases of minor divergences, the lower of the two estimates is used. Throughout this study a rather cautious and conservative approach is adopted and a number of figures of excess cost are rounded downwards.

Equalization (péréquation)

18. The "macro" approach is based on the figures of equalization (*péréquation*). This is the difference between the c.i.f. value of goods imported under USAID commodity loan agreements and the amount charged by the Government to local merchants for the same goods. The purpose of equalization is to enable the merchants handling the USAID-financed imports to earn a reasonable profit on those goods for which the United States prices are appreciably higher than the prices of the alternative

[5] For full details of the terms of the USAID loans, see the following publication: USAID, *Status of Loan Agreements*, Report W-224 (Office of the Controller, AID, Washington, D.C.). See also *Country Assistance Programme for Tunisia* (Department of State, Washington, D.C.).

sources of supply utilized by some importers not using USAID credits.

19. The amount of equalization is generally based on a comparison of United States with European c.i.f. prices, although in some cases the prices at which the goods can be disposed of internally are also taken into account. Since all imports (from the United States and other countries) are made under a licensing system, this is bound to result in a shortage of certain lines of goods and in higher internal prices. In such cases, the amount of equalization would, to the extent that it is influenced by the level of internal prices of these goods, tend to understate the difference between the United States c.i.f. prices and those of the alternative sources of supply.

20. The data on equalization are available only by major groups of commodities[6] shown in table 5 and only for the total shipments made under loans H-011, H-019 and H-024. For 1965, the information available consists of shipments by the same groups of commodities under each loan. To estimate the amount of equalization for 1965, it is assumed that the rate of equalization in that year for a commodity group financed by any loan is equal to the rate applicable to the total shipment of the same commodity group under that loan.

21. The estimates of the cost of aid derived from equalization have in all important cases been cross-checked by detailed " micro " work. This work, to which more than two thirds of the investigation time was devoted, consisted of examination of the original and of pro forma invoices of suppliers from the United States and from other countries; examination of quotations; and interviews with importers, with government officials and with the managers and staff of public enterprises.

22. In addition to providing a cross-check, this work has served two further purposes. Firstly, it has thrown some additional light on the subject of tying aid by providing examples of what might be called the unquantifiable costs of tying aid. Secondly, it has provided a number of examples of price differences on specific commodities which would lend themselves to a four-digit SITC classification, should such classification be eventually undertaken by UNCTAD.

Barter agreements

23. As noted in paragraph 13 above, some $8.3 million of the shipments made under commodity-loan agreements were procured outside the United States. This figure is made up of the following disbursements: $7.5 million spent on crude oil under loans H-019 and H-024, and $0.8 million paid for sugar under loan H-019. In view of the special arrangements permitting the procurement of these goods from third countries at world market prices, the disbursements made on them have been excluded from the category of tied economic assistance in tables 1 and 5.

24. The standard USAID commodity-loan agreements require that certain specified commodities, of which the United States is normally an importer, may not be financed by the loans. The list of these commodities, designated as " ineligible ", includes crude petroleum and sugar. This requirement is waived in the above two loan agreements by the insertion of a special clause which permits the import of crude oil and sugar from third countries under barter agreements acceptable to USAID, provided that at least 50 per cent of the shipments are made in United States flag vessels.

25. Briefly, the barter agreements were concluded as follows. Once the ineligible commodities to be imported from non-United States sources were agreed upon by USAID, the latter advised the Office of Barter and Stockpiling of the United States Department of Agriculture which, in turn, asked for bids for the purchase of surplus commodities in exchange for the export of the agreed goods (crude petroleum and sugar) to Tunisia. The winners of the bids were required to open letters of credit in favour of Tunisia for the import of the agreed goods from third countries and were then supplied with the surplus commodities for which they had bid.[7]

26. During 1965, crude oil was imported from the Middle East at free-market f.o.b. prices. The c.i.f. cost would, however, be somewhat higher owing to the requirement that at least 50 per cent of oil should be transported in United States flag vessels. Despite a number of efforts, no data could be obtained on the extra freight charges entailed by this requirement. The only indicator of the excess cost available, is that the shipments of crude petroleum under loans H-014 in 1963 and 1964 were invoiced to the Société tuniso-italienne du raffinage (the refinery enterprise) at 5 per cent below their c.i.f. value; a similar equalization was applied to the sales of sugar.

27. A point which, though not strictly relevant to 1965, is of some importance to the subject of tied aid, is that USAID is not now prepared to allow imports of ineligible goods from non-United States sources under barter agreements. This, in effect, amounts to tying to the United States suppliers the whole amount of the more recent commodity loans. But, at the same time, USAID has recently undertaken to direct in practice the utilization of the commodity loans to the more competitive United States products.

B. Excess cost of aid under commodity-loan agreements

28. Table 5 gives a rough indication of the excess cost of United States economic assistance under USAID commodity-loan agreements based on estimates of equalization in 1965. It should be noted that columns 2 and 3 of the table are derived from columns 1 and 4. Column 4 was obtained in the manner described in paragraph 20 above, the percentage of equalization being rounded to the nearest " 0 " or " 5 ".

[6] These groups are generally too broad to permit a four-digit SITC classification.

[7] For any additional information that may be required on barter agreements, refer to USAID or to the Office or Barter and Stockpiling of the United States Department of Agriculture, Washington, D.C.

29. It can be seen from table 5 that, for the imports tied to the United States source under the specified loans, the difference between the c.i.f. value of these shipments and the estimate of the c.i.f. value of the alternative sources of supply based on equalization is of the order of 20 per cent. This estimate of the excess cost has been cross-checked, wherever possible, by the detailed " micro " examination mentioned in paragraph 21 above. The " micro " work was confined to the commodity groups specified in lines 1 to 6 of the table, but in particular to those with a significant weight in the value of imports or in equalization during 1965. The following paragraphs illustrate the work done and point out some of the adjustments that could be made to the estimates of the excess cost of aid indicated in table 5.

30. It is a matter of judgement whether such adjustments are eventually made; the estimate of total excess cost is unlikely to change significantly. Moreover, table 5 has the merit of utilizing a uniform criterion for estimating the excess cost of aid—equalization—which, even if not very accurate for every commodity group, is fairly concrete and well defined.

Reinforcing bars[8]

31. Table 6 compares c.i.f. prices of a sample of shipments of reinforcing bars under the USAID programme from the United States with a sample of imports of similar bars from European countries in 1965. Enquiries from importers indicated that there was no significant difference in the quality of the bars of the same dimensions shipped from different countries. Some importers, however, thought that the United States bars were of somewhat greater resistance, but this was not considered very important as far as local Tunisian requirements were concerned.

32. The date of commencement of shipments and the terms of payment were not specified in the case of the United States, but one can assume that they were similar to those applicable to the European countries, although the delay in arrivals due to transport would be longer in the case of the United States. For the European countries the commencement of shipment is generally either immediate, or partly immediate (*ex-stock*) and partly subject to about one month's delay; payment is against shipping documents through letters of credit opened with banks.

33. It can be seen that the c.i.f. prices of country A were from 30 to 40 per cent lower than the United States prices for the various dimensions of the bars. Country C's prices were about 15 per cent and country B's some 25 per cent higher than those of country A, but nevertheless appreciably lower than the United States prices. These figures indicate that the equalization rate of 40 per cent on reinforcing bars shown in table 5 may be somewhat high as an estimate of the excess cost of aid; 30 per cent might be a safer estimate for this cost.

34. An important factor responsible for the price differentials between the United States and Western Europe was the higher cost of transport charged on the United States shipments; the insurance charge on reinforcing bars was rather insignificant—it was 0.33 per cent on f.o.b. prices for the United States. The freight charge on the United States imports was over $27 per metric ton, as compared with about $10 per metric ton on shipments from countries A and C.[9] This difference of about $17 per ton in freight alone accounts for a difference of 10 per cent in the c.i.f. prices of the thinner bars (10 and 12 mm) and of 13 per cent in the prices of the thicker bars (22 to 30 mm).

35. The existence of a wide gap between the c.i.f. prices of the United States and of the alternative sources of supply for reinforcing bars is universally recognized. USAID has recently decided to exclude this commodity from the list of goods to be shipped under the new commodity-loan agreements in line with its general policy noted above (see para. 27 above).

Motor buses[10]

36. Line 2 of table 5 represents the c.i.f. value of the components of 85 buses imported by a private firm (Import house IV) and sold to the Société nationale de transport; the latter has assembled these buses in Tunis and is currently using them as part of its transport fleet.[11] The components were supplied by various firms in the United States.

37. According to the Société nationale de transport, the buses that emerged after the assembly of the above components have proved to be inferior in many respects to similar buses bought from Europe and used in the fleet of the Société nationale de transport. It was said, in particular, that buses from Czechoslovakia and Italy were appreciably superior; those from Czechoslovakia had cost slightly less and those from Italy a little more.

38. The chief reason advanced for this opinion was the higher cost of repair incurred on the maintenance of the buses of United States origin; they had required more frequent repairs and the cost of spare parts imported from the United States is significantly—30 to 50 per cent—higher than the cost of similar spare parts obtained from Europe.

39. The United States buses also had a number of other drawbacks not all of which can easily be quantified: the chassis was designed for a truck and is too heavy for a bus; the rear door is too high for the convenience of passengers; and compared with the other two models of buses, passenger seats are narrower and the baggage compartment smaller. A senior engineer of the Société nationale de transport had in fact submitted a

[8] The work on this item consisted primarily of a scrutiny of the copies of invoices and import licences available in the Division de commerce, Secrétariat d'Etat au Plan et à l'économie nationale, Tunis.

[9] For country B, the freight charge was not stated separately on the pro forma invoice inspected, but this charge is unlikely to be much higher than that of countries A and C.

[10] The work on this item consisted of two interviews with the Director of Import house IV and two more extensive meetings with the staff of the Société nationale de transport.

[11] The cost of assembling each bus was estimated by the Société nationale de transport at $1,430.

memorandum to the management of the company some time ago in which were presented a dozen or more drawbacks, including those mentioned here, of the United States buses as compared with the similar European buses in the fleet.

40. At a rough guess, the Société nationale de transport estimated that the buses of United States origin had cost over 30 per cent more than buses of the same quality from other sources would have cost. The equalization rate of 25 per cent on motor buses shown in table 5 would, in the circumstances, appear to be a reasonable indicator of the excess cost of aid in this case.

Tractors and other agricultural equipment[12]

41. This commodity group contains a variety of equipment for which no meaningful inter-country price comparisons can be made owing to significant differences in specifications and performance between the supplies from different countries and manufacturers. Only in the case of a few items, notably tractors and combines, was it possible to make a reasonably reliable comparison of prices.

42. On the basis of the data obtained from invoices and quotations, it was estimated by Import houses II and III that for some type of equipment, e.g. some harrows, fertilizer-spreaders, mowers and balers, there was no significant difference between the United States and Western European c.i.f. prices. For a number of other implements, like some types of crawler-shovels and cultivators, the c.i.f. prices of the United States imports were found to be some 10 per cent higher than those of Western Europe. In a few other cases, of which one was quoted (a particular brand of baler), the United States prices were considered some 15 per cent lower than similar equipment imported from Europe.

43. It was possible to make a more detailed and accurate price comparison for tractors and combines which together carried a significant weight in the import of agricultural equipment in 1965. The price comparison is particularly accurate in those cases where identical or very similar models of equipment are produced by the same manufacturers in Western Europe and in the United States.

44. Table 7 shows recent (1967) quotations for this type of equipment. Since for the countries concerned changes in export prices during 1965-1967 have been rather small and of the same order of magnitude, it may safely be assumed that price ratios in 1967 reflect fairly accurately the price ratios of 1965. It can be seen from section A of the table that for identical models of two types of tractor, the c.i.f. quotations from other countries were 10 to 35 per cent lower than those of the United States.

45. According to Import house I and the North African representative of the manufacturers who was present at the interview, the particular models of tractors and combines produced in the United States and in country B, shown in section B of table 7, are identical in all essential respects. The sole difference between the equipment supplied by the two countries is in the additional accessories fitted to the United States models. The manufacturers' representative considered that these extra fittings could account at the most for a price difference of 10 per cent between the models mentioned in the table. It can be seen, however, that the actual difference in c.i.f. quotations was over 25 per cent for the tractors and almost 30 per cent for the combines. Bearing in mind the price differences indicated by table 7, the equalization rate of 22 per cent can be considered a reasonable estimate of the excess cost of aid for this commodity group.

Lubricants and tyres and tubes[13]

46. The general information gathered from the importers of lubricants was that the equalization rate of 30 per cent shown in table 5 represents a reasonable estimate of the excess cost of aid in this case. USAID authorities in fact recognize that import prices of lubricants from the United States are appreciably higher than those of the alternative sources of supply and have recently suggested to the Tunisian Government that it drop its request for the inclusion of lubricants under the new commodity loans.

47. According to the Société nationale de transport—a major consumer of tyres and tubes—the difference between the United States and European prices for tyres and tubes of similar size and quality is at least 10 to 15 per cent. This was confirmed by Import house V, which imports similar models of tyres and tubes from the United States and from Europe. It would appear that the equalization rate of 4 per cent somewhat understates the excess cost of aid in respect of this commodity group.

Textiles[14]

48. A large variety of goods are included in this commodity group ; most of these differ in detailed specifications—raw material content, weight, durability, design, etc.—from goods imported for similar purposes from other countries. This clearly makes a meaningful quantitative estimate of the excess cost of aid well-nigh impossible and what is said on this matter is no more than an educated guess on the part of the persons interviewed.

49. According to the staff of the Société générale des industries cotonnières, where a comparison can be made,

[12] The work on this item consisted of interviews with directors and staff of Import houses I, II and III, and of an examination of their invoices and quotations ; the three firms are major importers of agricultural equipment.

[13] The work on this item consisted of interviews with the staff of Société nationale de transport and Import house V.

[14] The work on this commodity group was confined to a lengthy interview with the senior staff of the Société générale des industries cotonnières, during which the United States prices were compared with those of the countries B, C and D for a number of items. It should be noted that the Société générale des industries cotonnières, which originally covered only the cotton industry, is now merged with the Société générale de l'industrie de laine and acts as a confederation of the whole textile industry.

some of the goods imported under USAID loans are found cheaper and many others more expensive than similar goods imported from Western Europe. The point emphasized was not, however, the price differential, but the unsuitability of some of the goods imported from the United States to local needs and tastes. This applied, for example, to some shirt-cloth, which was found unsuitable in terms of weight for local requirements. Part of the textile goods imported in earlier years under USAID loans initially sold well owing to their novelty but later found few buyers and the stocks had to be disposed of by importers at a heavy loss.

50. The personnel interviewed were prepared to venture the opinion that, on the whole, the excess cost of aid for textiles can be estimated at 10 per cent of the United States prices. It is, therefore, probable that the equalization rate of 1 per cent shown in table 5 is rather inadequate, i.e. too small, as an indicator of the excess cost of aid in this case.

51. To summarize this section, the detailed information on the commodity groups investigated leads to the general conclusion that the total amount and the average rate of equalization (about 20 per cent), shown in table 5, provide a reasonably conservative estimate of the excess cost of aid under USAID commodity-loan agreements in 1965.

C. Excess cost of project — tied aid

52. Particulars of the projects financed by this category of aid are given in table 8. Unlike the commodity-aid programme, it was not possible within the short period devoted to this study, to make estimates of the excess cost of aid in respect of most projects. Only three projects were investigated in any detail; these are specified in lines 2, 7 and 10 of the table.[15] It can be seen that these projects taken together accounted for over 70 per cent of total disbursements on project-tied aid in 1965.

Oued Nebana (dam)—USAID loan A-005[16]

53. The only records which were readily available on Oued Nebana project in Tunis consisted of expenditure by type of work, e.g. excavation, concrete work, filling, etc. But, it was also possible to identify the disbursement on a few major items of imports made for the project from the United States, such as reinforcing bars, steel pipes and hydraulic equipment; these accounted for a significant share of the total dollar disbursements. The prices charged on these items and the scale of salaries paid to the United States technical and administrative staff employed on the project were compared with the prices of similar goods and services available from Western Europe. On the basis of this rather incomplete examination, it was estimated that 20 per cent would be a conservative estimate of the excess cost of aid borne on this project.

Agricultural equipment—USAID loan H-016

54. Of the total disbursements of about $2.2 million made under this loan, it was possible to identify some $1.4 million of imports for which reasonably accurate price comparisons could be made; these consisted of certain models of tractors and combines discussed in paragraphs 44 and 45 above.

55. The following table gives details of the imports in question and of the estimates of excess cost incurred on them.

Imports under USAID loan H-016 in 1965

Description	c.i.f. value $US thousand	Excess cost (as percentage of 1)	Excess cost $US thousand
	1	*2*	*3 = 1 × 2*
1. Type I tractors . .	543	9	44
2. Type II tractors . .	706	36	254
3. Type I combines . .	124	18	22
	1,373	23	320

Sources: Import houses I and II and table 7 below.

Column 1 of the table represents c.i.f. value of imports from the United States and column 2 is obtained from table 7 as follows: the c.i.f. prices of the United States are compared with those of countries D, E and B for lines 1, 2 and 3 of the table, respectively. Regarding line 3—type I combines—the price differential of 28 per cent, shown in table 7, has been reduced to 18 per cent to allow for the price of the additional accessories mentioned in paragraph 45.

56. It can be seen that the excess cost on the three items shown in the above table amounts to 23 per cent of disbursements, which is strikingly similar to the rate of equalization applied to the purchases of tractors and agricultural equipment under commodity-loan agreements (see table 5, item 3). In this connexion, it may be reasonable to assume that the excess cost of aid in respect of disbursements under loan A-007 (line 4 of table 8) would also be of the order of magnitude of 20 per cent. As mentioned in paragraph 11 above, this loan was advanced to the Banque nationale agricole to finance private imports of agricultural equipment by farmers.

Diesel locomotives—Eximbank loan No. 2172[17]

57. The expenditure incurred on this project represents the c.i.f. value of 12 diesel locomotives of the

[15] Cost estimates on these projects are based on a personal evaluation of the author.

[16] The work on this project consisted of two interviews with the technical and financial staff of Hydraulique et équipement rural during which the available records of expenditure on the project were inspected.

[17] The work done on this project consisted of two interviews with the management and staff of source — the Société nationale des chemins de fer tunisiens; in addition, the tender invitation records and shipment documents were scrutinized.

following specifications: *Model GL, 8-metre gauge, type BB, 950/875 H.P. diesel electric locomotive.* The purchase was made through a tender invitation among United States suppliers.

58. The contract was signed on 9 December 1964 and the deliveries were made in three shipments of four locomotives each in 1965. The following details of cost have been extracted from the suppliers' invoices:

	$US thousand
First shipment	
Price, ex-factory at $141.8 each	567.2
Add: Under escalation clause, at $2.5 each	10.2
	577.4
Inland freight and dunnage	3.2
Ocean freight to Tunis	32.1
Insurance	2.0
TOTAL c.i.f. price, 4 locomotives	614.7
Second shipment	
c.i.f. price, 4 locomotives	621.3
Third shipment	
c.i.f. price 4 locomotives	621.1
TOTAL c.i.f. price 12 locomotives	1,857.1

59. According to the Société nationale des chemins de fer tunisiens, generally it would be difficult to make inter-country price comparisons for locomotives owing to many differences in specifications. However, prices quoted for such big orders can vary considerably from one period to another and from one manufacturer to another depending on the availability of productive capacity and on the position in the order books of suppliers at the time of quotation.

60. It was, nevertheless, emphasized that, had the aid not been tied to United States suppliers, the order would have been placed in a specified European country under the sale conditions prevailing in 1964/65. It was estimated that the prices of the European country would have been lower by 10 to 15 per cent on a f.o.b. basis, and by 13 to 18 per cent on a c.i.f. basis, as compared with the prices actually charged by the United States suppliers.

61. The persons interviewed, however, attached less weight to the initial price differential than to certain other costs of the United States transaction which cannot readily be quantified. These are:

(a) Longer delay in the delivery of spare parts from the United States as compared with Western Europe; this can be very costly in terms of the railway operations.

(b) Higher cost of individual consignments of spare parts obtained from the United States; the difference as compared with Western Europe could amount to 30 per cent or more (see also para. 38 on the relative prices of spare parts).

(c) Language difficulties—up to the date of interview (15 July 1967) it had not been possible to obtain from the suppliers a French version of the names of spare parts of which there are several hundreds; almost all the employees of the Société nationale des chemins de fer tunisiens can speak no foreign language but French.

62. It can be seen that the estimate of excess cost for each of the three projects examined are of the order of 20 per cent of disbursements. Since these projects accounted for over 70 per cent of total project-tied assistance in 1965, it may be reasonable to assume that the average excess cost in that year for this category of aid was also about 20 per cent. But this figure should be viewed with extra caution because, except in the case of project 7 (agricultural equipment), the estimates of excess cost for project assistance are based on a less clear and concrete foundation than those made for commodity-loan aid and are, for this reason, subject to a wider margin of error in either direction.

Chapter IV

Concluding note

63. The main conclusion emerging from this study is that a round figure of 20 per cent can be taken as a rough indicator of the order of magnitude of the excess cost of aid borne on the United States tied economic assistance given under commodity-loan agreements and for development projects in 1965. In absolute terms, the value of excess cost on this aid would thus amount to about $4 million, over one half of which represents the estimate of the excess cost incurred on commodity-loan aid (see below annex, table 5) and on the agricultural equipment project shown in table 8 (see paras. 29 and 56 above). No attempt has been made to quantify the costs of a number of other drawbacks of tying aid mentioned in paragraphs 38, 39, 49 and 61.

64. It has unfortunately not been possible, within the available time, to make a comparison between the ratios of excess costs of the tied economic assistance received from the United States and from the industrial countries of Eastern and Western Europe. But even if this ratio were proved to be lower in the case of the European countries, this would not necessarily signify that the economic value, or worth, of that aid was proportionately greater. The reason for this is the relatively harder credit terms charged on the European aid as compared with those applicable to the USAID loans (see paras. 1 and 14 above).

65. It is to be hoped that USAID will succeed in implementing its new policy of directing the utilization of the commodity-loans to more competitive United States products without reducing the volume of its aid to the country (see para. 27 above). It is further to be hoped that the implementation of this policy will not be accompanied by a further hardening of the credit terms of the USAID loans (see para. 13 above). Were this to happen, any economic gain received by Tunisia through a reduction in the excess cost of aid borne could be, partly, if not wholly, offset by the extra cost of servicing the loans.

ANNEX

Table 1

External public economic assistance to Tunisia in 1965, by source and type

($US thousand)

Source and description	Total 1 = 2 + 3 + 4	Free aid 2	Goods and technical assistance 3	Tied: Total 4 = 5 + 6	Tied: Project 5	Tied: Commodities (programme) 6
I. *United States*	*55,854*	*8,298*	*27,336*	*20,220*	*10,953*	*9,267*
1. *USAID Public Law 480* [a]	*23,587*		*23,587*			
(a) Title I	13,619		13,619			
(b) Title II	8,162		8,162			
(c) Title III	1,806		1,806			
2. *USAID project assistance*	*11,297*		*2,202*	*9,095*	*9,095*	
(a) Development loans	9,095			9,095	9,095	
(b) Project grants [b]	2,202		2,202			
3. *USAID commodity (programme) loans*	*17,565*	*8,298* [c]		*9,267*		*9,267*
4. *Other United States Government Agencies*	*3,405*		*1,547*	*1,858*	*1,858*	
(a) Export Import Bank	1,858			1,858	1,858	
(b) Peace Corps	1,500		1,500			
(c) United States Information Service	47		47			
II. *Western Europe*	*43,252*	*19,975*	*13,714*	*9,563*	*9,563*	
(a) Project assistance	9,653			9,563	9,563	
(b) Non-project assistance	19,975	19,975				
(c) Technical assistance grants [b]	13,714		13,714			
III. *North Africa and Middle East*	*7,333*	*2,857*		*4,476*	*4,476*	
(a) Libya	2,857	2,857				
(b) Kuwait	4,476			4,476	4,476	
IV. *Eastern Europe*	*3,650*			*3,650*	*3,381*	*269*
(a) Project assistance	3,381			3,381	3,381	
(b) Non-project assistance	269			269		269
V. *International organizations*	*2.600*			*2,600*	*2,600*	
(a) IBRD	1,076			1,076	1,076	
(b) IDA	1,524			1,524	1,524	
Total (I + II + III + IV + V)	112,689	31,130	41,050	40,509	30,973	9,536

Sources: Secrétariat d'Etat au Plan et à l'économie nationale, and Secrétariat d'Etat au Plan et à l'économie nationale, *Annexe statistique* (Tunis, undated).

[a] Including transfers to private sector; gross value of shipments before taking account of the United States use of counterpart funds.

[b] Including scholarships and training expenses.

[c] Crude oil and sugar.

TABLE 2

United States economic assistance to Tunisia: details of goods and services shipped under Public Law 480 in 1965

	Quantity (Tons)	*f.o.b. value (World market price)*	*Ocean freight (United States flag vessels) ($US thousand)*	*Total (c.i.f.)*
A. TITLE I				
Cotton:				
Fourth sales agreement	1,147	626	24	
Fifth sales agreement	1,111	587	—	
Total, cotton	2,258	1,213	24	
Other commodities:				
(Fifth sales agreement)				
Oil	17,881	4,885	—	
Wheat	92,392	5,386	—	
Feedgrain	38,244	2,111	—	
	148,517	12,382	24	
TOTAL, TITLE I	150,775	13,595	24	13,619
B. TITLE II				
1. *Programme to combat under development*				
Wheat	70,926	4,866	1,266	
2. *World Food Programme*				
Corn	4,972	309	63	
3. *Child feeding* [a]				
Wheat	10,346	706	174	
Milk	944	426	58	
Oil	420	190	8	
Beans	456	81	15	
Total, child feeding	12,166	1,403	255	
TOTAL, TITLE II	88,064	6,578	1,584	8,162
C. TITLE III [b]				
Flour	5,974	551	219	
Milk	556	211	33	
Oil	226	103	11	
Beans	374	54	11	
Bulgur wheat	2,096	200	69	
Cornmeal	2,027	175	67	
Rolled wheat	496	66	36	
TOTAL, TITLE III	11,749	1,360	446	1,806
TOTAL, PUBLIC LAW 480	250,588	21,533	2,054	23,587

Source: Secrétariat d'Etat au Plan et à l'économie nationale, *op. cit.*

[a] Distributed through the Secrétariat d'Etat à l'éducation nationale and the Secrétariat à la jeunesse, aux sports et aux affaires sociales.

[b] Distributed by voluntary agencies through the Secrétariat d'Etat à la jeunesse, aux sports et aux affaires sociales.

TABLE 3

Western European aid to Tunisia in 1965
($US thousand)

Source and Description	Total 1 = 2 + 3	Loans to: Government 2	Loans to: Public enterprises 3	Date of loan	Terms of loans: Percentage rate of interest p.a.	Terms of loans: Repayment period
I. *Project-tied Loans (1 + 2 + 3 + 4)*	*9,563*	*664*	*8,899*			
1. *Germany (Federal Republic)* . .	*2,739*	*491*	*2,248*			
(a) Three dams	76	76		3. 8.62	3.25	1970-1986
(b) Wjerba/Mehdia	415	415		29. 8.63	3.25	1970-1985
(c) Société tunisienne d'électricité et du gaz (1963) . .	1,000		1,000	22. 5.63	4.5	1966-1977
(d) Société tunisienne d'électricité et du gaz (1964) . .	1,248		1,248	5. 7.64	4.5	1967-1982
2. *France*	*6,476*		*6,476*			
(a) Loan No. 3	6,476		6,476	28.10.63	3.0	1967-1986
(b) Loan No. 4 . . . . (for steel, textile and glass factories)				27.10.64	3.5	1967-1986
3. *Denmark* (Office national de Pêche)	*175*		*175*	4. 9.64	4.0	1960-1982
4. *Sweden* (Port Kélibia)	*173*	*173*		29. 3.63	2.0	1968-1983
II. *Non-project (untied) assistance (5 + 6)*	*19,975*	*19,975*				
5. *Germany (Federal Republic)* . .	*5,000*	*5,000*		15. 6.65	3.0	by 1969
6. *Italy*	*14,975*	*14,975*				
(a) Ente Nazionale Idrocarburi loan	12,000	12,000		27.11.65	6.0	1968-1972
(b) Ente Nazionale Idrocarburi grant	2,975	2,975			Gift grant	
III. *Technical assistance grants* [a]	*13,714*	*13,714*				
TOTAL AID (I + II + III) per table 1	43,252	34,353	8,899			

Source: Secrétariat d'Etat au Plan et à l'économie nationale, *op. cit.*
[a] See footnote [b] to table 1.

TABLE 4

Aid received by Tunisia from Africa and the Middle East and from Eastern Europe in 1965
($US thousand)

Source and description	Total 1 = 2 + 3	Loans to: Government 2	Loans to: Public enterprises 3	Date of loan	Terms of loan: Percentage rate of interest p.a.	Terms of loan: Repayment period
A. Africa and Middle East						
I. Project-tied loans (1 + 2)	*4,476*	*1,733*	*2,743*			
1. *Kuwait* — Office de mise en valeur de la vallée de la Majerta	1,733	1,733		21.12.63	3.0	1968-1988
2. *Kuwait* — Société tunisienne d'électricité et de gaz	2,743		2,743	21.12.63	4.0	1968-1979
II. Non-project (untied) assistance . .	*2,857*	*2,857*				
Libya — purchase of State bonds	2,857	2,857			4.25	
TOTAL (I + II), per table 1	7,333	4,590	2,743			

TABLE 4 *(continued)*

Aid received by Tunisia from Africa and the Middle East and from Eastern Europe in 1965
($US thousand)

Source and description	Total 1 = 2 + 3	Loans to: Government 2	Loans to: Public enterprises 3	Date of loan	Terms of loan: Percentage rate of interest p.a.	Terms of loan: Repayment period
B. Eastern Europe						
I. Project-tied loans (1 + 2 + 3 + 4 + 5)	*3,381*	*2,164*	*1,217*			
1. *Bulgaria* — Olympic stadium	381	381		12. 2.63	3.0	In goods, 1968-1972
2. *German Democratic Republic* — Société générale de l'industrie confectionnaire	236		236	12.11.64	3.0	In goods, 1966-1970
3. *USSR* — Oued Kasseb (dam)	1,562	1,562		several, 1962/1964	3.0	In goods, in 12 years after completion
4. *Yugoslavia* — Office national de pêche (fishing) boats	813		813	26.10.63	3.0	In goods, 1965-1970
5. Other project aid [a]	389	221	168	several	3.0	In goods, 1965-1970
II. Non-project (untied) assistance	*269*	*269*				
USSR — credit	269	269				
TOTAL, (I + II), per table 1	3,650	2,433	1,217			

Sources: Secrétariat d'Etat au Plan et à l'économie nationale, *op. cit.*, tables 4.8, 4.9 and 4.10; and Secrétariat d'Etat au Plan et à l'Economie nationale.

[a] Assistance from several loans, received from Poland, Czechoslovakia and the USSR.

TABLE 5

USAID commodity-loan agreements: estimate of the excess cost of aid to Tunisia in 1965
($US thousand) [a]

Commodity group	Loans utilized	Import value (c.i.f.) 1	Invoiced to business at: 2	Equalization 3 = 1 — 2	Percentage rate of equalization 4 = 3 as percentage of 1
1. *Reinforcing bars*	H-011	1,132	679	453	40
	H-014	549	329	220	40
	H-019	470	306	164	35
	H-024	564	310	254	45
Total		*2,715*	*1,624*	*1,091*	*40*
2. *Motor buses*	H-014	*1,033*	*775*	*258*	*25*
3. *Tractors and other agricultural equipment*	H-011	203	142	61	30
	H-014	624	499	125	20
Total		*827*	*641*	*186*	*22*
4. Lubricants	H-024	*184*	*129*	*55*	*30*
5. Tyres and tubes	H-014	379	341	38	10
	H-019	438	438	—	—
	H-024	182	182	—	—
Total		*999*	*961*	*38*	*4*
6. Textiles	H-011	565	565	—	—
	H-014	111	94	17	15
	H-019	808	808	—	—
Total		*1,484*	*1,467*	*17*	*1*
7. Lumber	H-011	*258*	*232*	*26*	*10*
8. Butter	H-014	*848*	*848*	—	—
9. Soya oil	H-024	*507*	*507*	—	—
10. Spare parts	H-024	*56*	*56*	—	—
11. Miscellaneous commodities	H-014	*356*	*356*	—	—
GRAND TOTAL: *imports from United States per table 1*		9,267	7,596	1,671	18

Sources: Secrétariat d'Etat au Plan et à l'économie nationale, Tunis and Office du commerce de la Tunisie.

[a] Except for the totals and grand total, figures rounded to the nearest 0 or 5.

TABLE 6

Reinforcing bars: comparison of United States with European import prices, 1965

(c.i.f. prices; $US per ton)

Dimensions[a] (mm)	Prices				European prices as percentage of United States prices			
	United States	European countries[b]			United States	European countries[b]		
		Country A	Country B	Country C		Country A	Country B	Country C
10	169.40	105.06	133.50	121.46	100	62	79	72
12	164.28	100.02	128.50	116.46	100	61	78	71
14	153.28	99.01	...	114.46	100	65	...	75
16	153.28	97.00	124.50	112.45	100	63	81	73
22	133.44	95.99	...	...	100	72	...	...
25	133.44	95.99	122.50	...	100	72	92	...
30	133.44	...	...	110.45	100	...	...	83

UNITED STATES:

Invoice description:

" *Ronds à béton* ".

Sample: imports under licence numbers 30315, 30318, 40843, 40853, and 40861.

COUNTRY A:

Invoice description:

" *Ronds à béton en acier doux Thomas en longueur d'env. 12 m une fois pliés pour les 8 mm à 22 mm, en barres droites pour les 25 mm à 32 mm* ".

Sample: imports under licence numbers 30156, 30158, 94770 and 95606.

COUNTRY B:

Invoice description:

"*Acier tor, crénelés, selon DIN 1045 III b en longueur de 12 m, avec des tolérances usuelles* ".

Sample: imports under licence number 95421.

COUNTRY C:

Invoice description:

" *Ronds à béton, type LU 3/4400* ".

Sample: imports under licence numbers 97751, 98111 and 98187.

Source: Secrétariat d'Etat au Plan et à l'économie nationale, Division du Commerce (*pro forma* invoices).

[a] The dimensions quoted are those for which comparisons with United States prices could be made.

[b] In the case of countries A and C there are minor differences in prices (1-3 per cent) between shipments under different licences.

TABLE 7

Tractors and combines: comparison of United States with European quotations in 1967[a]

($US)

Description	United States prices		European prices		European as percentage of United States prices		
	f.o.b.	c.i.f.	f.o.b.	c.i.f.	f.o.b.	c.i.f.	Country
A. *Identical models:*							
1. Tractor type I	9,462	9,858	8,707	8,924	92	91	D
2. Tractor type II	3,498	3,824[a]					
From country D			2,804	2,916[a]	80	76	D
From country E			2,318	2,430[a]	66	64	E
B. *Similar models:*							
1. Tractor type III	3,586	3,912					
Tractor type IV			2,734	2,846	76	73	B
2. Combine type I	7,940	9,038					
Combine type II			6,000	6,550	76	72	B

Source: For A1 and B: Import house I; for A2: Import house II.

[a] The c.i.f. prices are estimated on the basis of the assumption that the cost of freight and insurance for A II is equal to that of B I, i.e. $326 for the United States and $112 for countries D and E.

TABLE 8

United States project assistance to Tunisia in 1965 (development loans) [a]

($US thousand)

USAID loan no.	*Description*	*Disbursement at United States prices*
A - 004	1. Société nationale des chemins de fer tunisiens	70
A - 005	2. Oued Nebana (dam)	3,855
A - 006	3. El Aouina Airport	290
A - 007	4. Banque nationale agricole (agricultural equipment)	303
A - 008	5. Société tunisienne des Banques (industrial equipment)	1,712
H - 012	6. Water project	8
H - 016	7. Agricultural equipment	2,244
H - 017	8. Société nationale tunisienne de celluloïde management	454
H - 021	9. Société tunisienne d'électricité et de gaz	159
	Total USAID	9,095
Eximbank loan No.		
2172	10. Diesel locomotives	1,858
	GRAND TOTAL: *project-tied aid* (per table 1)	10,953

Source: Secrétariat d'Etat au Plan et à l'économie nationale, Tunis; Hydraulique et équipement rural; and Société nationale des chemins de fer tunisiens.

[a] Excluding project grants.

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Costs and benefits of aid: an empirical analysis — by John A. Pincus**

[Original text: English]
[26 October 1967]

Summary

1. It is possible to evaluate the quantity of all forms of resource transfer from developed countries to developing countries by a common measure—the so-called grant equivalent, or real resource cost. By this method, grants, loans of whatever term or condition, contributions in kind, technical assistance, and foreign private investment can be valued at their net resource cost to donors, or their net benefit to recipients.

2. The method is based on reducing all loans to their grant equivalent, by estimating the present value of future repayment streams to donors and to recipients. These values will ordinarily differ as between donors and recipients for the same loan, because donors could have invested the sum they loaned at a rate of return that is different from the rate which the recipient could earn from investing the same sum domestically. If these alternative rates of return are known, the grant equivalent of the loan can be calculated by methods described below.

3. A second element in determining real costs and benefits is to make allowance for excess costs of aid-tying, when they exist. These costs will also normally be different for donor and recipient, even when the same goods are being valued.

4. This study reports on the grant equivalent of foreign aid costs to thirteen donor countries, as reported by the Organisation for Economic Co-operation and Development (OECD), from 1962 through 1966. The results indicate that the real resource cost of aid commitments averaged between 59 and 70 per cent of total official commitments, without including additional reductions below nominal values for certain elements in aid-tying.

5. The analysis also includes estimates of the grant equivalent to thirty-nine recipient countries for official borrowing commitments in 1960, 1964 and 1965, as reported by the International Bank for Reconstruction and Development (IBRD). Grant equivalents were generally far below the face value of borrowings, although an accurate estimate of the actual margin would require additional research.

6. The effective interest rates that developing countries pay on their borrowings are substantially higher than the contractual rate, whenever the lending is tied to the purchases of goods for which lender's prices substantially exceed world market prices. If, for example, the lender's prices for tied aid averaged 15 per cent more than world prices, then effective interest rates in 1964 would have been about 50 per cent higher than contractual rates, ranging from a 29 per cent margin to one of 76 per cent, depending on the terms and conditions of each country's borrowing.

7. In view of the perspectives on aid flows which the grant equivalent method offers and of the link which it provides between "qualitative" and "quantitative" factors in the flow of resources from developed to developing countries, further application and refinement of the method would be desirable.

8. The chief policy objectives of this study are:

(a) To strengthen the recipients' case for easing the terms of aid;

(b) To make explicit the costs to recipients of tied aid, thereby strengthening the case for untied borrowing;

(c) To draw attention to the conflict of immediate self-interest by clarifying the distinction between real costs to donors and real benefits to recipients;

(d) To facilitate donors' burden-sharing analyses by providing greater comparability between different forms of aid;

(e) To demonstrate the inadequacy of any single measure as a comprehensive guide to donors' aid efforts.

Introduction

9. The distinction between the quantity of foreign aid and its quality or terms, while valid for some purposes, is much affected by the nature of the inquiry.[1] If, for example, one is primarily interested in examining the balance-of-payments effects of aid, then the only major "qualitative" consideration is the comparison of the full effects of tied and untied aid. Similarly, if one is primarily interested in encouraging educational development in developing countries, or in promoting private

* Incorporating document TD/7/Supp.10/Corr.1.

** This study by Mr. John Pincus of the Rand Corporation has been prepared at the request of the Secretary-General of UNCTAD. The views expressed in the study do not necessarily reflect those of the UNCTAD secretariat.

[1] This distinction is maintained in the work programme of the Committee on Invisibles and Financing related to Trade (see *Official Records of the Trade and Development Board, Third Session, Supplement No. 3*, annex I).

capital flows from developed to developing countries, the relevant qualitative considerations change in each case.

10. The most important single reason, however, for distinguishing between quality and quantity of resource flows is that the official methods of measuring the quantity of resource flows combine a number of very different elements which, for many purposes, are not comparable to each other.

11. However, from a certain point of view, it is possible to reduce these disparate items to a common denominator: the "real cost" or "real benefit" of resource flows. From this viewpoint, most of the elements that are normally considered qualitative in nature, such as terms and conditions of loans, valuation of tied aid and valuation of private capital flows, can be given a quantitative meaning. The methods discussed in this paper should therefore be considered as providing a link between the quantitative and qualitative approaches to analysing the flow of external resources. The volume of resource flows is discussed in the UNCTAD secretariat study "Growth and external development finance"[2] and the "quality" of these flows is analysed in the note by the UNCTAD secretariat "The terms, quality and effectiveness of financial flows and problems of debt servicing".[3] This study offers a method of measurement which combines many elements of the qualitative and quantitative approaches in a single measure for each donor country and a different single measure for each recipient country.

Alternative measures of resource flows

12. How large is the financial contribution that rich countries make to poor ones? The question seems simple, but there is no single answer or, more exactly, the answer depends on the definition adopted. In theory, the flow of financial resources can be defined in the following different ways:

(a) Gross, without subtracting return flows of interest, amortization, dividends, capital repayment and capital exports;

(b) Net, to subtract some or all of these items and reinvested earnings of foreign enterprises;

(c) To include or exclude private investment;

(d) In so-called "real cost" terms, designed to measure the sacrifices made by donors;

(e) In "real benefit" terms, designed to measure the benefit to the recipient;

(f) In balance-of-payments terms, designed to show the direct and indirect effects of flows of financial resources on the foreign exchange position of both exporters and importers of capital.[4]

13. This analysis is concerned with items *(d)* and *(e)* in the foregoing list—real cost and real benefit. What is the meaning of "real costs" or "real benefits" in this connexion? The real cost of capital flows for a capital exporter is the income he foregoes as a result of the outflow of capital in the light of alternative possible uses of the same funds. For a capital importer the real benefit is measured by the net increment in income made possible by investing the capital inflow received, as compared with making the same investment with capital from other sources. Both real costs and real benefits can be measured approximately using existing data sources, although precise estimates would require a more comprehensive research effort than has yet been undertaken.

14. In order to explain the method, it is necessary to introduce the concept of a grant equivalent as a method of measuring capital flows. It is clear that for many purposes it would be a mistake to give equal weight to each dollar of capital outflow. A grant of one dollar costs the donor more than a ten-year interest-free loan of the same amount. That loan, in turn, costs him more than a credit, payable in one year, bearing 6 per cent interest. Therefore, the problem is how to find a method that will give each form of capital outflow its appropriate weight.

15. The answer is found by referring to a table of annuity values. Banks, insurance companies and other financial institutions are often faced with the need to put a present valuation on future cash flows. For example, a customer might ask an insurance company how much he would have to pay today in order to be assured of an annuity income of $1,000 annually starting at age sixty, twenty years from now, the income to continue for his normal life expectancy of twelve years thereafter. If the insurance company assumes that it can invest the customer's payment now at an interest rate of 5 per cent (over and above administrative costs, profits, etc.), then it can answer his question by referring to a table that shows the amount of money that one must invest today at 5 per cent return in order to produce the required sum of money from twenty to thirty-two years hence. Thus, to produce $1,000 twenty years from now it is necessary to invest $358.94 today at 5 per cent. Adding up this series of terms for the twelve-year period starting twenty years from now produces a sum amounting to $3,507.49. This is the sum of money that the customer would have to invest today at 5 per cent (excluding charges for the insurance company's costs and profits) in order to receive $1,000 per year for twelve years, starting twenty years from now and ending twelve years thereafter.

16. We can look at the same numbers a little differently and say that the present value of an annual income of $1,000 from 1987 to 1998 is $3,507.49, when discounted at an interest rate of 5 per cent. In other words, that future flow of income is worth $3,507.49 today.

17. The same analysis can be applied to the international flow of resources. Country A lends $1 million to country B at 3 per cent interest, to be repaid over twenty years in equal annual instalments, after an initial five-year grace period on amortization. This means annual interest payments of $30,000 for the five-year grace

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[2] Trade and Development Board document TD/B/C.3/34 and Corr.1 and 2.

[3] Trade and Development Board document TD/B/C.3/35 and Corr.1.

[4] See United Nations, "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" (*Official Records of the Economic and Social Council, Forty-first Session, Annexes,* agenda item 8, document E/4171).

period and annual payments of $67,215.71 for twenty years thereafter. What is the present value to the lender of this future flow of repayments? The answer depends on the rate at which the lender could invest the funds if they were not lent to country B. If the funds are raised by taxation, then the alternative is the long-term rate of safe return that private investors could earn, which is approximated in most capital-exporting countries by the going rate for real estate mortgages. If the rate were 3 per cent, the same rate as the actual loan, then the present value of the repayment flow would be $1 million. If the rate were higher, say, 6 per cent, then the present value of the repayment flow to the lender would be less than $1 million, because he could have invested the money at a 6 per cent return instead of a 3 per cent return. In the example cited here, the present value would be $702,487. In other words, with long-term domestic investments yielding 6 per cent, country A incurs a cost of $297,513 (equal to $1 million minus the present value of $ 702,487), when lending $1 million to country B at an interest rate of 3 per cent, repayable over twenty years with a five-year grace period.

18. This cost of $297,513 (amounting to nearly 30 per cent of the face value of the loan in this example) is called the "grant equivalent" of that particular loan, because it represents the present value of the foregone return on capital. It arises from the difference between market rates of return on investment (assuming that market rates reflect the social return to capital) and the lower return forthcoming from the actual loan made to country B. The grant equivalent will be a higher proportion of the face value of the loan *(a)* as the market rate of interest diverges more from the interest rate of the loan; and *(b)* the longer the grace period and the amortization period.

19. If the market rate of interest is equal to the loan rate, then the present value equals the amount of the loan and the grant equivalent is zero. If the market rate of interest is lower than the loan rate, then the "subsidy" to the borrower is negative, from the lender's viewpoint.

20. Figures I and II show how the grant element varies according to changes in the grace period and amortization period. Figure I shows grant elements as a percentage of the face value of loans where the alternative return on investment, or discount rate, is 10 per cent. Figure II is based on a 6 per cent discount rate, so that the grant equivalent of any particular set of loan terms and conditions is smaller than in figure I. Figure III shows how grant equivalents vary with changes in the discount rate.

Donors' cost approach

21. From this analysis we can develop a set of rules for determining real costs of capital flows to donors, as well as the real benefits to recipients. Let us begin with donors' official capital flows.

22. In principle a grant is 100 per cent grant equivalent. The grant equivalent of each official loan can be calculated, as described above, by computing the present value of the repayment streams of interest and amortization, discounted at each donor's market long-term interest rate. The difference between the amount of the loan and the present value is the grant equivalent.[5]

23. These two steps do not complete the task of estimating the real cost of donor's aid. Donor aid is often in the form of contributions in kind, such as surplus agricultural commodities. This aid should be valued depending on the case either at domestic prices or world market prices; or, if the quantity is large relative to world trade, at the additional revenue it would bring if sold on the world market. It is possible to estimate these figures approximately, and the discussion of the following paragraphs includes United States surplus food shipments valued at world prices.

24. Most official aid is tied to procurement in the donor country. To the extent that the costs of tied aid exceed the costs of procurement on a competitive world market, should aid be valued at world market prices for real cost comparison purposes?

25. With a few exceptions, world prices are not the appropriate guide to donors' real costs. Donors may often be high-cost producers of goods exported under foreign-aid financing, because of the effects of protective tariffs on the structure of domestic production and costs. Thus, if a donor country exports as aid the products of its protected machine tool industry at prices 25 per cent above world market levels, this is not necessarily an indication that its prices are 25 per cent above its real costs. It may simply be a high-cost producer of machine tools.

26. On the other hand, if the donor's tied aid price (normally equivalent to its domestic market price) is higher than the donor's normal commercial export price, there is a margin between prices and real costs because the donor is charging the recipient a higher price than it costs him to produce the goods for export. This element of monopoly pricing is in effect a subsidy from the donor Government to the producer (or, if the aid is in the form of loans, a subsidy from recipient to producer).

27. The amount of this subsidy, which is a deduction from donor's real cost, could be estimated by comparing prices paid by recipients of tied aid with prices paid for the same donor's untied goods by commercial importers. Such analyses have not yet been carried out, so that the exact effects on donors' real costs cannot be included in the present analysis.

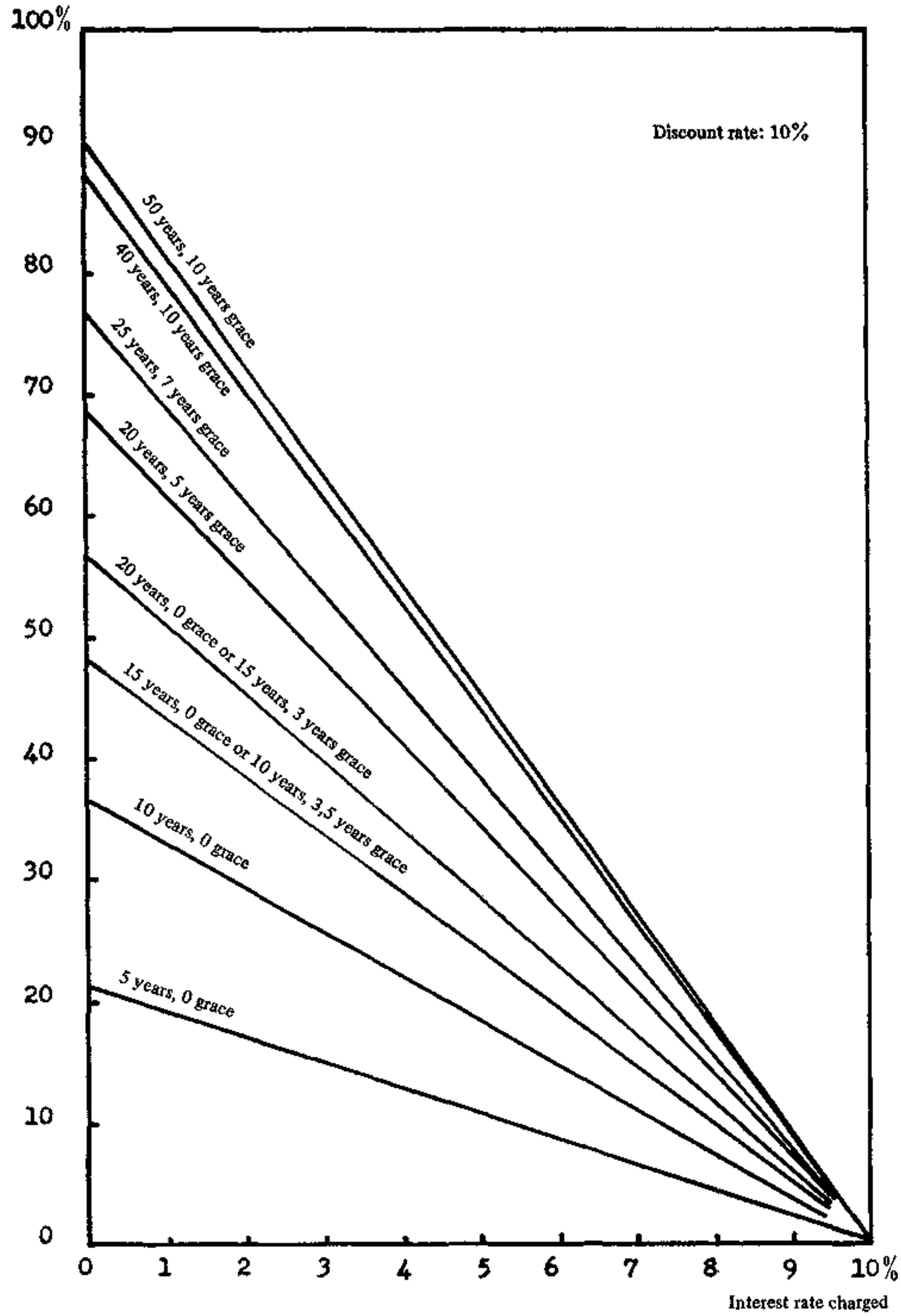
28. However, it is possible to give some rough estimate of the order of magnitude of these excess costs. It has been unofficially estimated that in 1965, if all United States aid were tied, its cost would have been about 17 per cent above that of the same goods at world prices. If we assume that the tied aid shipments were protected by United States tariffs averaging 12 per cent, which was the average United States import duty in 1965,[6] then, in

[5] If we assume that the alternative use of the loan funds is non-subsidized international official lending, rather than domestic investment, then the appropriate discount rate is the borrowing rate of IBRD as discussed below.

[6] Bela A. Belassa, "Tariff Protection in Industrial Countries: An Evaluation," *The Journal of Political Economy*, vol. LXXIII, Number 6 (Chicago, University of Chicago Press, December 1965), pp. 573-594.

FIGURE I

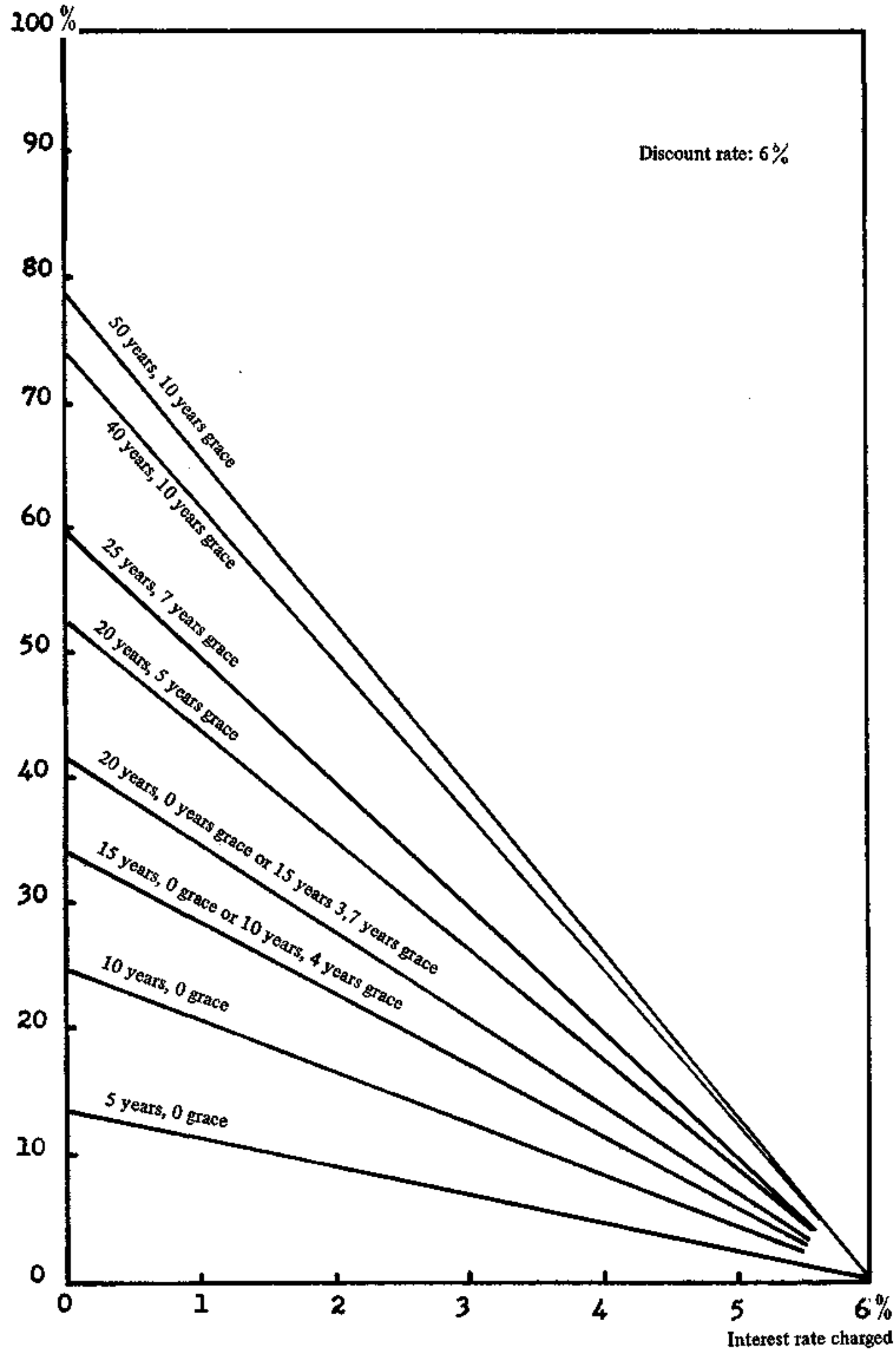
Grant element as percentage of face value



Source: OECD, *The flow of financial resources to less-developed countries, 1961-1965* (Paris, 1967).

FIGURE II

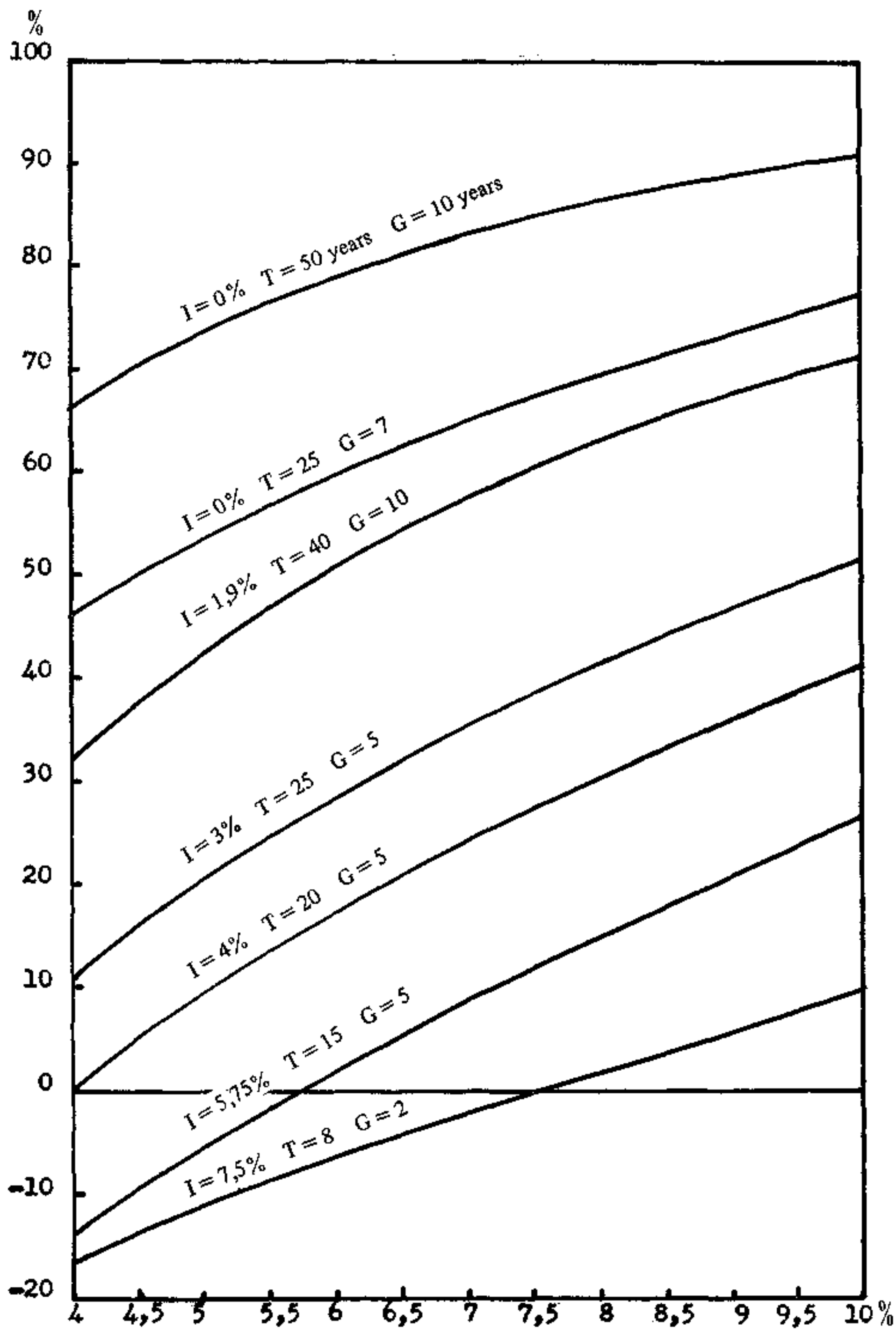
Grant element as percentage of face value



Source: OECD, *op. cit.*

FIGURE III

Grant element of typical loans as a function of the discount rate



Source: OECD, *op. cit.*

NOTE: I = rate of interest, G = duration of grace period, T = term of loan.

conditions of domestic competition, the average cost of these goods could be presumed to be 12 per cent higher than lowest world prices. If United States weighted average export prices for these products were 12 per cent above lowest world prices, reflecting the effects of protection, then the margin between tied aid prices and export prices in 1965 would have been about 5 per cent (equal to the 17 per cent margin above lowest world prices less the 12 per cent average excess cost).

29. These are obviously the roughest sorts of calculations. We have no assurance, in fact, that the exports financed by foreign aid were protected at this average duty rate. These figures can therefore not be incorporated into the analysis of donors' costs from 1962 to 1965, as set forth below. However, in interpreting these results, it should be remembered that they probably include some overstatement of the real costs of aid, perhaps of the order of 5 to 10 per cent in the case of the United States. More detailed analysis would allow a somewhat more accurate estimate of the degree of overstatement for each donor country.

30. Technical assistance is a special form of tied aid, in which expert services or training are the tied " commodities ". The real cost of these services to donors, for experts sent abroad, is probably somewhat less than their salaries and travel costs because it is a common practice to pay bonuses for foreign service, plus allowances for housing, education expenses and the like. To the extent however, that these bonuses are a part of the necessary cost, in a full-employment economy, of attracting experts to serve overseas, they are obviously a real cost to the donor, much as in the example of tied merchandise aid.

31. It is therefore possible to compute the real cost of official aid to donors in a full-employment economy as the sum of the following elements:

(a) Grants, including technical assistance at nominal value;

(b) Loans, of any terms and conditions, valued at the difference between their nominal value and the present value of repayments with present value discounted at a rate reflecting the market rate of return on long-term capital investment;

(c) Contributions in kind valued at world market prices (or when large quantities are involved, at market clearing prices);[7]

(d) Sales or loans, repayable in recipients' inconvertible currency, valued as grants, after making allowance for funds actually spent by the lender in the borrowing country.

32. Using these rules and a set of long-term interest rates shown below, tables A-1 to A-5, in the annex to this study, compare for the years 1962 to 1965 inclusive the real cost of aid commitments to donors with the totals as set forth by the Development Assistance Committee (DAC) of OECD in its annual reports on the flow of financial resources to developing countries.[8]

33. In tables A-1 to A-5, loans have been discounted at three different rates:

(a) *Donor's domestic long-term interest rate,* as represented by mortgage rates, or long-term government bond rates plus 1 per cent. This is the appropriate rate of discount to apply as a measure of donor's real cost. During the period, this rate was in the range of 4.9 to 8 per cent, depending on the country and the year.

(b) *The IBRD borrowing rate,* which is generally lower than the domestic discount rate. When donor's loans are discounted at this rate, it measures the cost to donors of bilateral aid, if the alternative were, as has sometimes been proposed, exclusive reliance on multilateral aid channels. In other words, use of the domestic discount rates shows the cost of aid if domestic investment is considered by the donor Government as the appropriate alternative to bilateral lending. Use of the IBRD discount rate shows the cost of aid if the choice is between bilateral loans and market-financed multilateral lending (see para. 58 below for discussion of further implications of different rates of discount). The IBRD borrowing rate used here ranged from 4.0 to 5.6 per cent and was a weighted average of actual rates for each year.

(c) *The rate of return which private investors in the donor country might have required* in order to make equity investments in developing countries. This is set at 10 per cent throughout and consequently produces a higher grant equivalent from any given loan than domestic interest rates would. Computations based on this interest rate essentially assume that foreign private investment is the alternative to intergovernmental lending. For most purposes, it is a less satisfactory measure of real costs than the domestic rates of return, as cited in subparagraph *(a)* above.

34. Contributions in kind under United States Public Law 480 (title I), which are listed in the DAC reports as " transfer of resources through sale for recipients' currencies ", are treated as grants and shown separately in tables A-1 to A-5, with a deduction for that portion of the local currency receipt reserved for United States

[7] These are valued at world prices rather than domestic prices because this item in practice consists almost entirely of United States farm surpluses for which foreign, rather than domestic sales, represent the only genuine alternative.

[8] As noted above the results of tables A-1 to A-5 slightly overstate donors' costs because they do not allow for divergence between donors' tied aid prices and donors' normal export price. The 1962 results shown in table A-1 vary slightly from a similar computation in John A. Pincus, *Economic Aid and International Cost Sharing* (Baltimore, Md., Johns Hopkins University Press, 1965), p. 140. The differences reflect: *(a)* computational methods in this study give a somewhat higher value to United States surplus commodity sales under title I of Public Law 480; *(b)* DAC aid figures for 1962 were revised slightly in OECD, *Development Assistance Efforts and Policies: 1965 Review* (Paris, 1965); *(c)* table A-1 was computed on the basis of average loan terms and conditions, rather than loan by loan. Table A-1 gives a real cost figure about $350 million higher than that shown in the earlier study. Half of this difference is attributable to methods of computing the present value of Public Law 480 commodities. The balance largely reflects revisions in official data on United Kingdom and Federal Republic of Germany aid totals for 1962, and the minor inaccuracies introduced in table A-1 by using average loan terms and conditions rather than exact ones.

government uses. The figures vary somewhat from those reported by the United States Government to DAC, for reasons explained in the annex to this report. Food grants offered under titles II and III of Public Law 480 are included under grants in tables A-1 to A-5, following DAC practice. In computing grant equivalents, these sums have been reduced by amounts which reflect the difference between the values of the commodities as reported to DAC, and their estimated world market value (see annex for details).

35. These computations exclude private investment flows from developed to developing countries, because they do not represent real costs to the donor. We are concerned here with measuring the real costs, in the sense of the difference, if any, between rates of return on resource use at home and rates of return derived from transfers to developing countries. In the case of private investment, this difference is normally zero or negative because investors go abroad in search of profit: and if profits at home were greater, the funds would not flow overseas. The only subsidy on real donors' cost elements involved is the actual cost of government investment guarantees, which is negligible although it should be included in the totals for the sake of completeness.

36. Using this definition of donors' real cost, the computations of tables A-1 to A-5 show the following results:

(a) The real cost, or grant equivalent, of donors' aid commitments during the period 1962-1966 ranged from 63.5 per cent to 70.9 per cent of the values as reported to DAC, when the aid was discounted at donor's domestic interest rates. The following table compares the fourteen donors' nominal and real costs for the five years.

Year	*Cost as reported to DAC ($US million)*	*Real cost at domestic discount rate ($US million)*	*Column 3 ÷ Column 2*
1962 . . .	7,917	5,403	.682
1963 . . .	6,623	4,070	.614
1964 . . .	7,740	4,936	.638
1965 . . .	7,173	5,119	.714
1966 . . .	8,715	6,068	.696

Table 1 gives rates of real to nominal costs for each donor. The range by country was from a real/nominal cost ratio of 11 per cent (Italy, 1963) to 100 per cent, indicating all grant aid (Australia, Belgium, Denmark, Norway).

(b) The value of official loans averaged 42 per cent of the nominal value of donors' aid commitments during the period 1962-1966, equal to an average of $3.2 billion annually. Only about one fourth of this sum, on the average was a real cost to donors, in terms of their domestic alternatives. Table 2 shows the real cost ratio of official loans, so discounted by country for each of the five years. The grant element of loans varied widely

TABLE 1

Ratio of grant-equivalent aid to total official aid commitments, DAC countries, 1962-1966

(Loans discounted at donors' domestic interest rate)

Country	*Grant-equivalent as percentage of official commitment*				
	1962	*1963*	*1964*	*1965*	*1966*
Australia	100.0	100.0	100.0	100.0	100.0
Austria	28.4	72.0	26.6	15.5	11.1
Belgium	100.0	100.0	97.9	98.6	95.8
Canada	81.2	43.5	57.7	67.9	87.5
Denmark	100.0	100.0	78.4	75.2	85.6
France	87.8	82.6	80.7	83.1	85.8
Germany (Federal Republic)	55.5	39.8	59.9	57.3	63.2
Italy	25.9	11.8	51.5	26.8	23.3
Japan	87.5	44.1	56.9	44.3	48.7
Netherlands	86.4	70.3	79.7	77.9	79.9 [c]
Norway	100.0	100.0	94.8	96.5	100.0
Portugal	15.1	30.2	22.5	36.0	36.0 [c]
United Kingdom	48.3	60.1	67.2	70.3	78.7
United States [a]	62.9	62.9	59.0	73.0	64.9
Total [b]:	65.4	61.4	63.9	69.9	66.4

Sources: Annex, tables A-1 to A-5.

[a] Excluding Public Law 480, title I. Including Public Law 480, title I, United States percentages are:

1962 - 70.9
1963 - 66.6
1964 - 65.1
1965 - 75.1
1966 - 70.8

[b] Excluding Public Law 480, title I. Including Public Law 480, title I, DAC percentages are:

1962 - 70.2
1963 - 63.5
1964 - 67.0
1965 - 70.9
1966 - 69.6

[c] Based on estimated data.

TABLE 2

Grant element in DAC donors' official bilateral lending commitments, 1962-1966

(Loans discounted at donors' domestic interest rate)

Country	Grant element as percentage of official loan commitment				
	1962	1963	1964	1965	1966
Australia	a	a	a	a	a
Austria	0.0	20.7	7.5	1.9	0.9
Belgium	a	a	29.2	25.8	27.4
Canada	0.1	0.1	14.0	30.2	45.5
Denmark	a	a	25.4	17.4	61.3
France	13.5	11.5	20.0	16.1	18.2
Germany (Federal Republic)	17.7	18.1	20.7	25.6	36.7
Italy	0.1	1.3	13.0	7.3	11.5
Japan	6.9	7.1	12.5	11.3	12.3
Netherlands	11.7	3.7	18.0	24.1	31.0
Norway	a	a	9.2	21.7	a
Portugal	8.4	16.3	5.5	10.0	10.0
United Kingdom	10.3	14.7	28.1	33.6	57.8
United States	27.7	36.7	33.0	21.4	29.1
All donors: weighted average	21.7	25.2	28.5	20.6	28.1

Sources: See table 1.
[a] No loan commitments.

TABLE 3

Grant element in DAC donors' official bilateral lending commitments, 1962-1966

(Domestic interest rate, $US million)

Country	1962	1963	1964	1965	1966
Australia	a	a	a	a	a
Austria	a	0.2	1.2	0.7	0.7
Belgium	a	a	0.7	0.5	1.5
Canada	0.1	0.5	11.8	33.3	26.1
Denmark	a	a	0.9	1.0	8.3
France	19.3	20.0	56.0	34.5	32.0
Germany (Federal Republic)	55.6	94.6	57.7	100.1	130.2
Italy	0.7	1.8	17.1	18.9	49.5
Japan	1.2	9.6	11.2	22.5	25.3
Netherlands	1.2	0.8	3.7	7.8	10.3
Norway	a	a	0.1	0.1	a
Portugal	3.3	7.3	2.0	2.4	2.4
United Kingdom	36.7	35.4	102.6	73.6	147.0
United States	471.9	555.8	783.8	328.9	559.9
Total	590.0	726.0	1048.8	624.3	993.2

Sources: See table 1.
[a] No loan commitments.

by country and year, from zero (Austria, 1962) to 61 per cent (Denmark, 1966). Table 3 gives the figures for the grant element of loans in dollar equivalents of the percentages shown in table 2.

(c) When bilateral loans were discounted at the IBRD borrowing rate, their "real cost" averaged only about one seventh of the face value of loans. For many donors, these costs were negative before 1966, indicating that the interest rates actually charged by donors for bilateral loans were higher than the average IBRD borrowing rate. For these countries (which included, in most years, Austria, Canada, Italy, and Japan, and in two early years also the Federal Republic of Germany and the United Kingdom), a switch from bilateral lending to purchase of IBRD bonds would have meant a slight increase in total real costs of aid on the assumption that such purchases were the most probable alternative to bilateral lending. For all countries combined on this assumption, however, a switch from bilateral lending to multilateral development bank purchases would have involved annual combined savings averaging $342 million over the period (equal to about one seventh of the face value of loans,

as noted above). During the period 1962-1966 there was a marked shift from negative to positive grant equivalents under this discount rate. In 1966, all donor countries' loans had positive grant equivalents, when discounted at this rate, indicating that in that year their bilateral loans were made at lower rates of interest than the average IBRD borrowing rate. The grant equivalent in that year at the IBRD discount rate (5.6 per cent) was nearly one fourth of the face value of the loans.

(d) When a discount rate of 10 per cent was applied to all donors' loans, the grant equivalent of official lending was much larger than under either the lender's domestic discount rate or the IBRD average borrowing rate. The comparison of the three methods for all donors combined was as follows :

($US million)

Grant equivalent of loan commitments, thirteen donors with loans discounted at:	*1962*	*1963*	*1964*	*1965*	*1966*
1. Donor's domestic interest rate . . .	590.0	726.0	1,050.0	624.3	993.2
	(21.7)[a]	(25.2)	(28.5)	(20.6)	(28.1)
2. IBRD borrowing rate	244.8	823.7	565.6	304.7	833.4
	(9.0)	(11.2)	(15.4)	(10.5)	(25.6)
3. 10 per cent	1,298.3	1,438.8	1,990.8	1,308.7	1,708.2
	(47.8)	(50.0)	(54.1)	(43.2)	(48.8)
Nominal value of loan commitments . . .	2,714.5	2,877.2	3.681.9	3.027.0	3,553.9

[a] Percentage of nominal value in parentheses.

At the 10 per cent discount rate, the "real cost" of loans averaged nearly one half of nominal cost over the five-year period, as compared to one fourth and one seventh respectively for the domestic and IBRD discount rates. The only circumstances in which it would be appropriate to apply this rate as a measure of real cost would be in the event that the real alternative facing the donor were investments bearing a 10 per cent net return. Such a situation might emerge if the reduction in bilateral official lending were accompanied by official measures to stimulate high-yielding foreign investments, as under an investment-guarantee or tax credit programme. However, under current conditions, it should be regarded as illustrative of special conditions rather than as a concrete estimate of real costs.

37. The data permit certain comparisons of real costs among countries. Tables A-1 to A-5 offer year-by-year data for 1962 through 1966. Table 1 compares, by year and country, at donor's discount rates, the ratio of real costs to official commitments for all forms of official aid combined. Tables 2 and 3 show the same information for official loan commitments only. In general, as might be expected, the real cost/nominal cost ratios are highest—close to 100 per cent—for countries that offer mostly grants (Belgium, Canada, Denmark, France, Norway), and lowest—below 50 per cent—for those that offer mostly loans at interest rates that approach the level of domestic discount rates (Austria, Italy, Japan, Portugal). Three of the major donors (Federal Republic of Germany, United Kingdom, United States) occupy an intermediate position, with grant equivalent of commitments ranging from 50 to 75 per cent of the totals reported to DAC.

38. Tables 4 and 5 compare nominal costs and grant equivalents to donor's national output for the years 1962-1965. Table 4 gives each donor's official commitment (as reported to DAC) as a percentage of gross national product (GNP) by year, in both nominal costs and grant-equivalent terms. There are some striking variations between the two methods. First, for all DAC countries combined during the period, nominal costs ranged from 0.58 per cent of donors' GNP (1963 and 1965) to 0.80 per cent (1962). Grant equivalents were about one third lower, ranging from 0.36 per cent (1963) to 0.55 per cent (1962). Among donor countries, Portugal drops from second to sixth when aid/GNP ratios are valued at grant equivalent; Austria, from eighth to last; and the Federal Republic of Germany from sixth to eighth. French and Belgian official aid are relatively high in grant equivalent, followed by the Netherlands, the United States and the United Kingdom, which has recently adopted a policy of interest-free lending, thereby significantly increasing the grant elements in its aid programme. United States average loan terms and conditions became somewhat more stringent in 1964 and 1965 (see table 2) but grants were a somewhat larger percentage of total United States aid commitments in 1965 than in 1962-1964.

39. The tables showing grant equivalents are all based on official aid commitments, because Governments and DAC usually present data on loan terms on a commitment basis. However, for many purposes, it would be useful to compare the flow of resources on both nominal and real cost bases. Table 5 shows official aid flows as a percentage of GNP and compares these ratios to grant-equivalent flows on the same basis. The grant-equivalent estimates of table 5 are based on the assumption that aid flows were advanced on the same terms as current year aid commitments. This undoubtedly reduces the accuracy of the estimates but for the four-year period as a whole, the margin of error so introduced is probably small (see part III of the annex for discussion). Nominal flows for all donors combined ranged from 0.49 per cent of GNP (1964 and 1965) to 0.59 per cent (1962). Grant equivalents ranged from 0.32 per cent of combined GNP (1964) to 0.40 per cent (1962). France and Belgium made the largest relative contributions in 1965 in both norminal and grant-equivalent terms. The principal shifts as between the two methods of costing were Portugal (third to seventh), Austria (seventh to twelfth), Netherlands (eighth to fifth) and Canada (tenth to eighth). The United States, the United Kingdom, and the Federal Republic of Germany were third, fourth and sixth respectively when donors' aid flows were ranked by grant-equivalent percentages in 1965.

40. This analysis bears an evident relation to recommendation A.IV.2, "Growth and aid", adopted by the United Nations Conference on Trade and Development at its first session.[9] If one object of the resolution is

[9] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 43.

TABLE 4

Estimated grant-equivalent commitments of official aid as percentage of gross national product, 1962-1965

(Official commitments as percentage of GNP)

Country	1962		1963		1964		1965		Rank among donors according to percentage of GNP, 1965	
	Nominal Cost	Grant Equivalent [a]	Nominal Cost	Grant Equivalent	Nominal Cost	Grant Equivalent	Nominal Cost	Grant Equivalent	Nominal Cost	Grant Equivalent
Austria	0.11	0.03	0.03	0.02	0.23	0.05	0.48	0.11	8	13
Belgium	0.62	0.62	0.68	0.66	0.52	0.51	0.67	0.65	3	2
Canada	0.17	0.14	0.33	0.13	0.39	0.22	0.46	0.31	9	(6)
Denmark	0.10	0.10	0.17	0.17	0.16	0.13	0.20	0.15	(12)	11
France	1.39	1.22	1.09	0.90	1.01	0.82	1.11	0.92	1	1
Germany (Federal Republic)	0.65	0.36	0.75	0.30	0.47	0.26	0.56	0.30	6	8
Italy	0.38	0.10	0.34	0.04	0.32	0.09	0.33	0.14	11	12
Japan	0.51	0.21	0.48	0.17	0.44	0.14	0.38	0.17	10	10
Netherlands	0.54	0.43	0.33	0.20	0.34	0.26	0.57	0.44	5	3
Norway	0.20	0.20	0.38	0.37	0.11	0.11	0.20	0.19	(12)	9
Portugal	1.53	0.23	1.79	0.54	1.43	0.35	0.92	0.31	2	(6)
United Kingdom	0.77	0.37	0.61	0.37	0.57	0.22	0.50	0.35	7	5
United States [b]	0.88	0.62	0.62	0.41	0.78	0.51	0.58	0.43	4	4
Total	0.80	0.55	0.58	0.36	0.67	0.43	0.58	0.43		

Source: Tables A-1 to A-4; GNP from International Monetary Fund (IMF) *International Financial Statistics*.

[a] Discounted at donor's domestic interest rate.

[b] Including Public Law 480, title I, at market prices.

TABLE 5 *

Estimated grant-equivalent flow of official aid as percentage of GNP 1962-1965

(Official flow as percentage of GNP)

Country	1962		1963		1964		1965		Rank among donors according to percentage of GNP, 1965	
	Nominal Cost	Grant Equivalent [a]	Nominal Cost	Grant Equivalent	Nominal Cost	Grant Equivalent	Nominal Cost	Grant Equivalent	Nominal Cost	Grant Equivalent
Austria	0.19	0.05	0.03	0.02	0.17	0.04	0.37	0.08	7	12
Belgium	0.61	0.61	0.64	0.63	0.53	0.52	0.72	0.70	2	1
Canada	0.14	0.11	0.24	0.10	0.29	0.16	0.25	0.17	10	8
Denmark	0.09	0.09	0.12	0.12	0.12	0.09	0.13	0.10	13	11
France	1.33	1.17	1.05	0.87	0.95	0.76	0.82	0.67	1	2
Germany (Federal Republic)	0.51	0.29	0.46	0.19	0.41	0.23	0.39	0.21	6	6
Italy	0.28	0.07	0.25	0.02	0.11	0.03	0.17	0.07	(11)	13
Japan	0.15	0.06	0.21	0.07	0.15	0.05	0.29	0.13	9	10
Netherlands	0.68	0.54	0.26	0.16	0.29	0.22	0.34	0.26	8	5
Norway	0.15	0.13	0.37	0.36	0.27	0.27	0.17	0.16	(11)	9
Portugal	1.46	0.22	1.71	0.51	1.98	0.49	0.65	0.22	3	7
United Kingdom	0.52	0.25	0.49	0.29	0.54	0.32	0.49	0.36	5	4
United States [b]	0.66	0.47	0.64	0.42	0.55	0.36	0.55	0.40	4	3
Thirteen DAC countries [b] *Total*	0.59	0.40	0.56	0.35	0.49	0.32	0.49	0.35		

Source: Tables A-1 to A-4. Nominal percentages from OECD, *Development Assistance Efforts and Policies, 1966 Review* (Paris, 1966).

* This table assumes that the terms and composition of aid flows in each year were the same as those of current year aid commitments.

[a] Discounted at donor's domestic interest rate.

[b] Including aid granted under Public Law 480, title I, at market prices.

to call for equal resource contributions by donors, in the form of a minimum of 1 per cent of each developed country's income, then grant equivalents offer a more logical approach to measuring relative resource contributions than does the unweighted summing of grants, loans and private investment.

41. Before going on to discuss the matter from the viewpoint of recipients, a few points concerning the assumptions and methods of donors' cost analysis are in order. First, this analysis is based on the assumption that resources in donor countries are relatively fully employed. If they are not, the only loss involved in resource

transfers, including grants, is that stemming from the difference between capital depreciation arising from producing goods exported under the aid programme and capital depreciated when machinery and equipment are left idle. Naturally, in an underemployed donor economy there is always the alternative of devoting the resources of domestic projects rather than to foreign aid and in that sense there is a " cost " to aid. But it is not a real resource cost, unless the proposed domestic projects are actually adopted and also succeed in restoring full employment. If the domestic projects are not adopted, then they cannot be counted as cost in a period when there are no available opportunities for profitable use of capital and labour.

42. A second assumption implicit in the real cost analysis is that prices of goods and services reflect the operation of competitive markets for merchandise, labour and capital. To the extent that monopoly elements affect prices, then the real cost of goods exported is less than the market price. Although monopoly elements are undoubtedly widespread in capital-exporting countries, the excess cost so produced is considered to be only a small fraction of national product.[10] Therefore, the use of market prices as an indicator of real costs introduces only negligible overstatement and one that is probably roughly equal as among donor countries. This overstatement is probably considerably smaller than that introduced by the discrepancy between tied aid prices and commercial export prices for the same products, as discussed above.

43. It should also be noted that the grant equivalent of each year's commitment or flow of resources is measured without subtracting the current year return flow elements that stem from debt servicing of prior loans. This follows because the grant-equivalent approach is in effect a netting out of future return flows. It is the difference between nominal values and grant-equivalent values that gives rise to debt service payments. To substract those payments out would therefore be a form of double counting.

Recipients' benefit approach

44. The same real-cost analysis for capital flows can be applied from the viewpoint of recipients' benefit. The values will normally diverge from those shown in tables A-1 to A-5, under the donors' cost definition, for several reasons.

45. Firstly, the interest rate for discounting will usually be different in donor and recipient countries. The higher the long-term real rate of interest in the recipient country, the larger the grant equivalent of a loan. Thus, for the $1 million loan cited above, offered at an interest rate of 3 per cent for twenty years, with a five-year grace period and a donor's discount rate of 6 per cent, the donor's grant equivalent was $297,513. For a recipient who would have to pay 8 per cent in order to raise capital domestically, the grant equivalent of the same loan would be $437,780. Naturally, if the recipient's discount rate is lower than the donor's, the grant equivalent to recipients will be less than that to donors.

46. Secondly, in cases where foreign exchange controls are practised, one appropriate rate for discounting is that which the recipient would have to pay on the international securities market, as measured for example by bond rates (including flotation costs) for countries that are able to float international market loans (for example, Mexico, Jamaica, Israel); or by the effective rates for suppliers' credit in other cases.[11]

47. Thirdly, from the viewpoint of aid recipients, tied aid may reduce the grant equivalent of aid if the prices charged for goods by the supplier exceed the world price. Thus the calculation of effective rates of interest charged for suppliers' credits, as discussed in the preceding paragraph, should include an adjustment of effective interest rates to allow for the difference, if any, between suppliers' prices and world prices. The appropriate adjustment for over-pricing of tied aid is very difficult to calculate because of the differences in the quality and specifications of goods supplied by different exporters. Relatively accurate estimates of the costs of tied aid are possible only for standardized commodities such as agricultural products, raw materials, and semi-finished bulk goods. For many consumer goods, machinery and other forms of capital equipment, problems of non-comparability arise to impede the price comparisons. Despite the many difficulties that arise in estimating the excess costs to recipients involved in tied aid, some indications are available. One study of the costs of tied aid to Pakistan concluded that the aid actually received by that country in recent years could have been purchased for 12 per cent less if all aid were untied.[12] It has been estimated that purchasing all United States aid-financed commodities in the United States resulted in a 17 per cent excess cost, as compared to world market prices, for the year 1965.

48. A fourth difference between the donors' cost and recipients' benefit estimates concerns the " grant equivalent " of private investment. From the viewpoint of the national economy, the grant equivalent is the difference between the discounted value of foreign investors' future return on investment (where the percentage return on investment is used as the rate of discount) and the host country's own discount rate for capital. If the investor's rate of return is higher than the host country's borrowing rate for foreign capital of the same maturity, then the " grant equivalent " is negative.

49. In practice, the only way to measure foreign investors' discount rates of return on equity investment is to make three simplifying assumptions : *(a)* new investment will earn the same average rate of return as existing

[10] H. Leibenstein, " Allocative Efficiency vs. X-Efficiency," *The American Economic Review, The Journal of the American Economic Association* (California, Stanford University, June 1966), pp. 392-415.

[11] In pure theory the appropriate rate of discount for recipients could be viewed as the marginal social rate of return for capital at equilibrium exchange rates. Thus, in countries with overvalued currencies, the recipients, discount rate would have to be increased to take account of over-valuation.

[12] Mahbub ul Haq, " Tied Credits—A Quantitative Analysis," in John Adler and Paul W. Kuznets eds., *Capital Movements and Economic Development : Proceedings of a Conference held by the International Economic Association* (London, Melbourne, Toronto, Macmillan and Co. Ltd.—New York, St. Martin's Press Inc. 1967), p. 326.

investment; *(b)* future rates of return will be the same as current rates; *(c)* foreign investors will reinvest depreciation allowances, so the income stream arising from the investment stream can be assumed to continue indefinitely.

50. This type of calculation necessarily abstracts from certain technical assistance and technology transfer elements inherent in much private investment, unless these accrue to the investor in the form of higher rates of return. Both of these effects (training and "know-how") add to the recipient's benefit and thus, in effect, raise his rate of discount and hence also the grant-equivalent ratio of each unit of private capital inflow. However, the practical difficulties of measurement are so great that it is best treated as a qualitative consideration.

51. All these considerations—the difficulty of establishing appropriate discount rates or appropriate values for tied aid, and the simplifying assumptions required for calculating recipients' benefits from private investment—have the effect of reducing the accuracy of estimated grant equivalents for recipients' benefits, as compared to those based on a donor's cost definition.

52. However, the results of such calculations may be of some interest for comparing with the donors' lending cost ratios shown in table 2. In order to avoid the major sources of estimating bias discussed above, the computation of tables 6 and 7 below show only the grant equivalent of official borrowing for recipient countries. Table 6 is based on data published by IBRD,[13] showing the official borrowing commitments for thirty-nine developing countries for the years 1960, 1964 and 1965. Table 6 compares nominal values of loans received by these countries with grant equivalents, discounted at three different rates: the IBRD lending rate; 8 per cent, as a rough estimate of the costs of private foreign loans or suppliers' credits; and 12 per cent, as a rough estimate of recipients' domestic return on investment.

53. With loans discounted at the IBRD lending rate, the analysis assumes that the recipients might have had the alternative of borrowing from IBRD instead on the terms actually borrowed. This assumption is clearly unrealistic in terms of the present situation, but it does show what the costs or benefits would be to recipients if they could do all their borrowing at IBRD rates. In 1960, there were seventeen countries in this group that would have been at least as well off, in terms of grant equivalent, had they borrowed at IBRD rates rather than from the actual lending sources. Ten countries in that year were able to borrow at rates that were more favourable than IBRD average lending rates. By 1964, the relative terms on which these developing countries were able to borrow had improved, and only six of the countries in the group would have benefited in real cost terms from a switch to IBRD lending rates. By 1965, the total declined to just one country—Paraguay. In other words, the loans from developed to developing countries in 1960 were generally advanced on terms less favourable than IBRD rates, while by 1965 developing countries were, on the average, able to borrow at rates below those charged by IBRD. However, part of the increase in grant equivalent derived from the favourable lending terms introduced by IDA after 1960, so that the World Bank Group itself played an important part in the increasingly favourable borrowing terms recorded.

54. The average rate at which developing countries might have secured loans in the world market, via bond flotations, suppliers' credits and other forms of free-market lending was undoubtedly higher than the IBRD lending rate. Table 6 includes a computation for foreign private lending rate, discounted at 8 per cent. In all cases, the actual loan terms secured were more favourable than the hypothetical private rate, and improved, from the borrowers' viewpoint, from 1960 to 1964.

55. From the viewpoint of borrowers' marginal rate of return to domestic investment set at 12 per cent in table 6, there was a substantial grant equivalent to recipients in most cases. This domestic rate of return obviously varies widely by country, and 12 per cent is simply a hypothetical average. In a more detailed analysis, the computations would be based on actual domestic long-term rates of return, but these are not generally known because money markets in developing countries are still rudimentary. There is typically no established mortgage rate, domestic bond market or other market indicators of return to capital.

56. For the thirty-nine countries combined, the following table compares nominal values of loans with grant equivalents for the three years, at each of the three discount rates discussed above.

[13] International Bank for Reconstruction and Development—International Development Association *1965-1966 Annual Report*, p. 36; and *1966/1967 Annual Report*, pp. 36-37.

Combined value of borrowings and grant equivalents for thirty-nine countries 1960, 1964 and 1965

Year		*Grant equivalent discounted at:*		
	Nominal value of borrowing	*IBRD borrowing rate*	*"Private foreign lending" rate*	*"Domestic investment" rate*
		($US million)		
1960	2,278.7	58.6	314.3	710.6
		(2.6)	(13.8)	(31.2)
1964	3,355.0	473.6	1,013.2	1,592.3
		(14.1)	(30.2)	(47.5)
1965	2,665.0	482.7	826.3	1,302.1
		(18.1)	(37.5)	(48.9)

Note: Figures in parentheses show percentage of nominal value.

TABLE 6

Thirty-nine developing countries' official borrowing commitments and grant equivalents, 1960, 1964 and 1965

($US million and percentage of nominal value)

Country		Value of borrowings 1960	Grant equivalent discounted at:			Value of borrowings 1964	Grant equivalent discounted at:			Value of borrowings 1965	Grant equivalent discounted at:		
		Nominal value	IBRD lending rate (6.0%)	"Private foreign" lending rate (8.0%)	"Domestic Investment" rate (12.0%)	Nominal value	IBRD lending rate (5.5%)	"Private foreign" lending rate (8.0%)	"Domestic Investment" rate (12.0%)	Nominal value	IBRD lending rate (6.0%)	"Private foreign" lending rate (8.0%)	"Domestic Investment" rate (12.0%)
Argentina	dollars	241.0	0.0	21.0	56.2	18.2	−0.6	1.8	4.8	221.4	3.4	19.7	48.1
	percentage	100.0	0.0	8.7	23.3	100.0	−3.3	9.9	26.4	100.0	1.5	8.9	21.7
Chile	dollars	45.8	−2.5	2.3	10.2	148.1	27.7	54.6	82.9	179.3	34.7	61.1	96.8
	percentage	100.0	−5.5	5.0	22.3	100.0	18.7	36.9	56.0	100.0	19.4	34.1	54.0
China (Taiwan)	dollars	...	...	...	...	...	...	...	...	110.5	4.5	18.0	38.9
	percentage									100.0	4.1	16.3	35.2
Colombia	dollars	50.7	0.0	7.7	18.7	194.1	25.9	63.7	102.7	...	...	...	...
	percentage	100.0	0.0	15.4	36.9	100.0	13.3	32.8	52.9				
Costa Rica	dollars	15.5	0.0	1.4	3.8	13.9	−0.1	1.4	3.4	19.3	3.2	5.8	9.6
	percentage	100.0	0.0	9.0	24.5	100.0	−0.7	10.1	24.5	100.0	16.6	30.0	49.7
Dominican Republic	dollars	...	...	...	...	92.7	3.7	12.9	25.4	22.1	4.3	7.3	11.5
	percentage					100.0	4.0	14.0	27.6	100.0	19.5	33.0	52.0
Ecuador	dollars	0.1	0.0	0.1 [a]	0.1 [b]	46.0	11.4	20.4	28.9	17.7	1.3	3.2	6.2
	percentage	100.0	0.0	1.0	10.0	100.0	24.8	44.3	62.8	100.0	7.3	18.1	35.0
El Salvador	dollars	3.8	0.1	0.7	1.5	...	...	...	...	6.3	1.9	2.7	3.9
	percentage	100.0	2.6	18.4	39.5					100.0	30.2	42.8	61.9
Ethiopia	dollars	12.1	0.3	1.1	2.4	39.2	0.3	7.6	15.8	24.1	2.9	5.7	10.0
	percentage	100.0	0.3	9.1	19.8	100.0	0.8	19.4	40.3	100.0	12.0	23.6	41.5
Guatemala	dollars	24.8	1.1	3.5	7.5	4.8	0.1	0.8	1.7	4.7	2.9	3.4	4.0
	percentage	100.0	4.4	14.1	30.2	100.0	2.1	16.7	35.4	100.0	61.7	72.3	85.1
Guyana	dollars	...	...	...	...	...	...	...	...	7.8	2.8	3.9	5.3
	percentage									100.0	35.9	50.0	67.9
Honduras	dollars	8.9	0.0	1.4	3.4	5.6	1.8	2.7	3.6	18.3	6.2	8.9	12.1
	percentage	100.0	0.0	15.7	38.2	100.0	32.1	48.2	64.3	100.0	33.9	48.6	66.1
India	dollars	501.1	67.6	129.5	222.3	546.5	141.6	246.9	347.0	710.0	220.0	322.3	451.2
	percentage	100.0	13.5	25.8	44.4	100.0	25.9	45.2	63.5	100.0	31.0	45.4	63.5
Iran	dollars	61.3	−0.5	8.5	21.7	87.7	1.8	12.2	25.7	...	...	...	...
	percentage	100.0	−0.8	13.9	35.4	100.0	2.1	13.9	29.3				
Israel	dollars	81.6	−0.5	8.7	23.4	106.4	7.1	22.4	41.1	...	...	...	...
	percentage	100.0	−0.6	10.7	28.7	100.0	6.7	21.1	38.6				
Jamaica	dollars	...	...	...	...	...	...	...	...	19.6	1.0	3.9	8.0
	percentage									100.0	5.1	19.9	40.8
Kenya	dollars	22.3	−0.2	3.2	8.0	25.4	3.8	9.1	14.2	57.6	3.4	12.3	24.7
	percentage	100.0	−0.1	14.3	35.9	100.0	15.0	35.8	55.9	100.0	5.9	21.4	42.9

Korea, Republic of	dollars	...	...	...	...	...	...	...	...	122.6	36.2	54.0	76.6
	percentage									100.0	29.5	44.0	62.5
Madagascar	dollars	...	...	...	...	...	...	...	...	0.4	0.1 [g]	0.1	0.2
	percentage									100.0	25.0	25.0	50.0
Malaysia	dollars	32.8	−1.0	3.6	10.3	...	...	...	...	73.7	3.5	13.4	28.1
	percentage	100.0	−3.0	11.0	31.4					100.0	4.7	18.2	38.1
Mexico	dollars	378.4	−4.4	36.8	103.2	567.5	−12.2	45.5	123.4	...	...	...	...
	percentage	100.0	−1.2	9.7	27.3	100.0	−2.1	8.0	21.7				
Morocco	dollars	...	...	...	...	...	...	...	...	110.4	18.4	33.0	54.2
	percentage									100.0	16.7	29.9	49.1
Nicaragua	dollars	14.3	0.0	2.3	5.5	13.9	1.3	4.0	6.9	17.0	2.7	5.4	8.9
	percentage	100.0	0.0	16.1	38.5	100.0	9.4	28.8	49.6	100.0	15.9	31.8	52.3
Nigeria	dollars	50.4	−1.8	4.8	14.8	251.7	8.7	54.6	106.0	117.3	33.1	50.9	73.2
	percentage	100.0	−3.6	9.5	29.4	100.0	5.3	21.7	42.1	100.0	28.2	43.4	62.4
Pakistan	dollars	135.8	4.1	27.3	58.9	667.4	228.5	349.9	461.4	262.6	73.1	109.6	158.0
	percentage	100.0	3.0	20.1	43.4	100.0	34.2	52.4	69.1	100.0	27.8	41.7	60.2
Panama	dollars	17.8	2.1	4.2	7.4	26.4	3.1	7.9	13.1	...	...	...	...
	percentage	100.0	11.8	23.6	41.6	100.0	11.7	29.9	49.6				
Paraguay	dollars	0.2	0.0	0.1 [c]	0.1 [d]	16.6	3.2	6.5	9.9	14.1	−0.3	1.7	4.6
	percentage	100.0	0.0	0.5	1.0	100.0	19.3	39.2	59.6	100.0	−2.1	12.1	32.6
Peru	dollars	143.7	−10.7	6.6	34.1	153.4	2.3	27.8	57.9	136.0	1.1	18.6	45.6
	percentage	100.0	−7.5	4.6	23.7	100.0	1.5	18.1	37.7	100.0	0.8	13.7	33.5
Philippines	dollars	24.3	0.3	3.2	7.8	100.7	0.6	14.3	31.7	146.4	0.7	9.5	25.2
	percentage	100.0	1.0	13.2	32.1	100.0	0.6	14.2	31.5	100.0	0.5	6.5	17.2
Senegal	dollars	...	...	...	...	...	...	...	...	10.8	2.8	3.9	5.7
	percentage									100.0	25.9	36.1	52.8
Southern Rhodesia	dollars	5.6	0.0	0.5	1.4	3.9	0.0	0.8	1.6	...	...	...	...
	percentage	100.0	0.0	8.9	25.0	100.0	0.0	20.5	41.0				
Sudan	dollars	47.8	4.2	8.8	16.2	...	...	...	...	62.5	7.0	15.5	28.0
	percentage	100.0	8.8	18.4	33.9					100.0	11.2	24.8	44.8
Tanzania	dollars	4.2	0.0	0.6	1.5	25.8	9.6	14.2	18.3	...	...	...	...
	percentage	100.0	0.0	14.3	35.7	100.0	37.2	55.0	70.9				
Thailand	dollars	0.3	0.0	0.1 [e]	0.1 [f]	24.5	0.0	4.7	10.1	5.0	0.1	0.9	2.0
	percentage	100.0	0.0	3.3	16.7	100.0	0.0	19.2	41.2	100.0	2.0	18.0	40.0
Trinidad and Tobago	dollars	...	...	...	...	...	...	...	...	35.6	6.5	11.4	18.4
	percentage									100.0	18.3	32.0	51.7
Uganda	dollars	16.8	0.2	2.8	6.4	0.9	0.2	0.3	0.5	4.0	0.1	0.6	1.4
	percentage	100.0	0.1	16.7	38.1	100.0	22.2	33.3	55.5	100.0	2.5	15.0	35.0
Uruguay	dollars	...	...	...	...	96.3	3.9	13.7	26.9	14.1	2.3	4.1	6.7
	percentage					100.0	4.0	14.2	27.9	100.0	16.3	29.1	47.5
Venezuela	dollars	337.3	1.2	23.8	64.0	70.8	0.0	11.2	24.7	24.3	0.2	2.8	6.9
	percentage	100.0	0.3	7.0	19.0	100.0	0.0	15.8	34.9	100.0	0.8	11.5	28.4
Zambia	dollars	...	...	...	...	7.3	−0.1	1.3	2.8	82.5	2.0	10.5	24.3
	percentage					100.0	−1.3	17.8	38.4	100.0	2.4	12.7	29.5

Source: Commitments, terms and conditions from IBRD/IDA, *Annual Report, 1965-1966* and *Annual Report, 1966/1967.*

[a] 0.001 [b] 0.01 [c] 0.01 [d] 0.02 [e] 0.01 [f] 0.05 [g] 0.07.

TABLE 7

Fourteen developing countries' official borrowing commitments and grant equivalents, 1960 and 1964

(Discounted at current rates of interest on their external bonds)

Country	Official borrowings, 1962				Official borrowings, 1964			
	Nominal value ($US million)	Grant equivalent ($US million)	Interest rate (percentage)	Grant equivalent nominal value (percentage)	Nominal value	Grant equivalent ($US million)	Interest rate (percentage)	Grant equivalent nominal value (percentage)
Argentina	241.0	...	...	...	18.2	3.2	9.8	17.6
Chile	45.8	1.9	7.8	4.1	148.1	48.0	7.3	32.4
Colombia	50.7	6.6	7.7	13.0	194.1	55.8	7.4	28.7
Costa Rica	15.5	1.0	7.4	6.5	13.9	1.8	8.7	12.9
Ecuador	0.1	0.007	10.5	0.7	46.0	13.9	6.1	30.2
Mexico	378.4	...	...	...	567.5	9.5	6.4	1.7
Nigeria	50.4	2.7	7.3	5.4	251.7	30.5	6.6	12.1
Panama	17.8	0.9	5.1	5.1	26.4	2.0	5.0	7.6
Peru	143.7	0.9	7.3	0.6	153.4	4.6	5.7	30.0
Philippines	24.3	...	...	...	100.7	8.6	6.9	8.5
Southern Rhodesia	5.6	0.9	9.5	16.1	3.9	1.0	8.9	25.6
Tanzania	4.2	0.9	9.0	21.4	25.4	15.4	8.9	60.6
Uganda	16.8	3.9	9.0	53.6	0.9	0.4	8.3	44.4
Uruguay	...	...	...	...	96.3	9.6	6.9	10.0

Source: Table 6 and IBRD, " Prices and yields of selected external government bonds in various markets " 27 January, 1965.

57. During the period 1960-1965, the grant-equivalent ratios of borrowing increased steadily for all recipients combined, as shown in the percentage figures in parentheses on page 123 above. The trend indicates a general easing of loan terms and conditions during the period. These aggregates conceal a great variation among countries. For a few countries (Iran, Mexico, Philippines, Costa Rica), average borrowing conditions did not improve. The general conclusion is that the real resource gain to developing countries from their borrowings is, by any likely rate of discount, well under half of the nominal value of loans.

58. Some empirical confirmation of this conclusion is available. Fourteen of the thirty-nine countries had external bond issues floated in major private money markets (New York, London, Paris). Table 7 shows the current interest rate on their bonds in 1960 and 1964 and also the present value of their official borrowings in those years discounted at the external bond interest rate listed in the table. In 1960, data were available for ten countries. In that year their official borrowings totalled $345.2 million. If they could have borrowed those sums at the reigning private money market rate for their bonds, they would as a group have been only $19.7 million worse off than if none of their official borrowings had been floated on money markets at these rates. However, this $19.7 million combined grant equivalent (equal to 5.7 per cent of nominal value) undoubtedly understates the real benefits derived by developing countries from borrowing from other Governments, international agencies and foreign private suppliers. The amounts of bonds that most developing countries are able to place in external money are quite limited and the real interest cost of floating additional bonds would increase sharply with the quantity borrowed. This is true *a fortiori* for 1964, when the fourteen countries borrowed $1,646.5 million, at a grant-equivalent benefit of $204.3 million (or 12.4 per cent of nominal value) when discounted at the current interest rate on their external bonds.

59. For each of the foregoing grant-equivalent comparisons, except when discounted by the hypothetical domestic rate, the grant equivalents shown are comparisons of actual terms with terms available under other forms of borrowing. The IBRD rate, the " private foreign lending " rate, and the current external bond rate comparisons are not the measures of the recipients' total benefit accruing from official borrowings in the various years. They measure only the difference in benefit between those arising from actual terms and conditions of lending, and those arising from borrowings at the alternative rates hypothesized in tables 6 and 7. The sole measure of total benefit is found in the difference between rates of interest actually charged and marginal rates of return to capital in the borrowing country.[14] Therefore, in order to develop more precise estimates of recipients' grant equivalent, it would be necessary to investigate the actual effective rates of interest (or return) on long-term investments in developing countries.

Effects of aid-tying on recipients' benefit

60. The foregoing estimates of grant equivalents did not include an allowance for recipients' extra costs accruing from tied aid, although these appear to have been substantial, adding 12-17 per cent to total costs in the examples cited above in this study. The effect of

[14] Or abroad, if the borrower reinvests the funds elsewhere; but this is assumed to be exceptional in the case of development borrowing.

TABLE 8

Interest cost of tied borrowing to thirty-nine recipient countries, 1960, 1964 and 1965

Country	*Interest rates on 1960 borrowing*				*Interest rates on 1964 borrowing*				*Interest rates on 1965 borrowing*			
	Nominal rate percentage	*Effective Rate* 10% *tying cost*	15% *tying cost*	20% *tying cost*	*Nominal rate percentage*	*Effective Rate* 10% *tying cost*	15% *tying cost*	20% *tying cost*	*Nominal rate percentage*	*Effective Rate* 10% *tying cost*	15% *tying cost*	20% *tying cost*
Argentina	6.0	8.2	9.4	10.8	6.1	8.0	9.0	10.1	5.6	8.6	9.7	11.2
Chile	7.0	8.9	10.0	11.2	3.6	4.5	5.0	5.6	4.0	4.9	5.4	6.0
China (Taiwan)	...	...	...	...	...	...	...	...	5.4	6.9	7.6	8.5
Colombia	6.0	7.1	7.8	8.5	4.2	5.1	5.6	6.1	...	...	...	...
Costa Rica	6.0	8.1	9.3	10.6	5.6	7.9	9.2	10.5	4.1	5.2	5.7	6.4
Dominican Republic	...	...	...	...	4.6	6.9	8.1	9.5	3.8	4.8	5.4	6.0
Ecuador	6.0	12.4	15.8	19.5	3.4	4.1	4.5	4.9	4.8	6.4	7.2	8.2
El Salvador	5.8	6.9	7.5	8.1	...	...	...	...	3.0	3.9	4.3	4.8
Ethiopia	5.3	8.2	9.9	11.6	5.4	6.6	7.2	7.9	4.3	5.6	6.4	7.2
Guatemala	5.2	7.1	8.1	9.2	5.4	6.8	7.5	8.3	1.1	1.6	1.8	2.1
Guyana	...	...	...	...	...	...	...	...	2.9	3.5	3.9	4.3
Honduras	6.0	7.1	7.7	8.3	2.1	3.0	3.5	4.0	3.1	3.7	4.1	4.4
India	4.2	5.5	6.1	6.9	3.3	4.0	4.4	4.8	3.2	3.9	4.3	4.7
Iran	6.1	7.3	8.0	8.8	5.1	7.0	8.1	9.2	...	...	...	...
Israel	6.1	7.8	8.5	9.7	4.5	6.0	6.8	7.7	...	...	...	...
Jamaica	...	...	...	...	...	...	...	...	5.4	6.5	7.1	7.8
Kenya	6.1	7.2	7.9	8.6	4.2	5.0	5.4	5.9	5.4	6.4	7.0	7.7
Korea, Republic of	...	...	...	...	...	...	...	...	3.3	4.0	4.4	4.9
Madagascar	...	...	...	...	...	...	...	...	2.9	4.6	5.5	6.5
Malaysia	6.4	7.7	8.4	9.2	...	...	...	...	5.4	6.7	7.4	8.1
Mexico	6.2	8.0	8.9	10.0	6.0	8.4	9.8	11.2	...	...	...	...
Morocco	...	...	...	...	...	...	...	...	4.0	5.1	5.7	6.4
Nicaragua	6.0	7.1	7.7	8.4	4.5	5.5	6.0	6.6	4.4	5.3	5.8	6.3
Nigeria	6.5	7.9	8.7	9.5	5.1	6.2	6.9	7.6	3.5	4.2	4.6	5.1
Pakistan	5.7	6.7	7.3	7.9	2.7	3.3	3.7	4.1	3.2	4.0	4.5	5.0
Panama	4.4	5.7	6.4	7.2	4.2	5.3	5.8	6.5	...	...	...	...
Paraguay	5.6	11.9	15.5	19.3	3.8	4.6	5.1	5.6	6.3	7.7	8.4	9.3
Peru	7.2	8.9	9.8	10.9	5.3	6.6	7.4	8.2	5.9	7.3	8.1	9.0
Philippines	5.8	7.4	8.2	9.1	5.4	7.1	8.0	9.1	5.8	9.1	11.0	13.0
Senegal	...	...	...	...	...	...	...	...	2.5	3.7	4.3	5.0
Southern Rhodesia	6.0	8.1	9.2	10.5	5.5	6.5	7.1	7.8	...	...	...	...
Sudan	4.4	6.2	7.2	8.0	...	...	...	...	4.7	5.8	6.4	7.1
Tanzania	6.0	7.1	7.8	8.5	2.5	3.1	3.4	3.8	5.8	6.9	7.5	8.2
Thailand	6.0	9.6	11.5	13.6	5.5	6.7	7.3	8.0	4.0	5.0	5.5	6.1
Trinidad and Tobago	...	...	...	...	...	...	...	...	5.6	6.9	7.8	8.6
Uganda	5.9	7.0	7.6	8.2	4.1	4.9	5.3	5.8	3.9	5.1	5.7	6.4
Uruguay	...	...	...	...	4.6	6.9	8.1	9.5	5.9	7.7	8.7	9.8
Venezuela	5.9	8.9	10.5	12.3	5.5	6.9	7.7	8.6	5.6	7.4	8.4	9.5
Zambia	...	...	...	...	5.7	6.8	7.4	8.1	...	...	...	...

Source: See note to table 6 above.

this aid-tying from the recipient's viewpoint, is to raise the effective interest rate he actually pays on the loan. This happens because out of each dollar of borrowing he receives only, in the examples above, 88 cents or 83 cents worth of merchandise and services. Therefore, he is repaying one dollar plus interest for every 83 cents or 88 cents worth of purchasing power he receives. This amounts to a concealed extra interest payment from the recipient's viewpoint.

61. What is the amount of the extra interest arising from tied borrowings? Table 8 compares, for the thirty-nine countries of table 6, the effective interest rates on three assumptions about the excess costs of tying: 10, 15 and 20 per cent. On the basis of empirical data now available, the average cost of tying to recipients probably falls within this 10-20 per cent range.

62. Under these assumptions, table 8 shows the following effects:

(a) Nominal rates of interest paid by each country in 1960 ranged from an average of 4.2 per cent (India) to 7.2 per cent (Peru). Effective interest rates ranged from a minimum of 5.5 per cent (India, 10 per cent tying cost) to a maximum of 19.5 per cent (Ecuador, 20 per cent tying cost).

(b) In 1964, nominal rates were lower, ranging from an average of 2.1 per cent (Honduras) to 6.1 per cent (Argentina). Effective rates varied from 3.0 per cent (Honduras, 10 per cent tying cost) to 11.2 per cent (Mexico, 20 per cent tying cost).

(c) In 1965, both nominal and effective rates remained around the 1964 levels. The nominal rates ranged from 1.1 per cent (Guatemala) to 6.3 per cent (Paraguay). Effective interest rates were as low as 1.6 per cent (Guatemala, 10 per cent tying cost) and as high as 11.2 per cent (Argentina, 20 per cent tying cost).

(d) Effective rates for 1960 under the 15 per cent tying cost assumption were from a minimum of 30 per cent higher than the nominal rate (Tanzania) to a maximum of 176 per cent higher than the nominal rate (Paraguay). The difference between nominal and effective rates in 1964, under the 15 per cent assumption, ranged from 29 per cent (Southern Rhodesia) to 76 per cent

TABLE 9

Twenty-eight developing countries' official borrowing commitments, 1964, compared to grant equivalents under tied and untied aid

Country	Nominal value of loans ($US million)	Grant equivalent: Untied loans		Grant equivalent: Tied loans	
		$US million	*Percentage of nominal*	*$US million*	*Percentage of nominal*
Argentina	18.2	4.8	26.4	2.1	11.5
Chile	148.1	82.9	56.0	58.6	39.6
Colombia	194.1	102.7	52.9	71.8	37.0
Costa Rica	13.9	3.4	24.5	1.3	9.4
Dominican Republic	92.0	25.4	29.6	11.3	12.3
Ecuador	46.0	28.9	62.8	21.4	46.5
Ethiopia	39.2	15.8	40.3	9.7	24.7
Guatemala	4.8	1.7	35.4	1.0	20.8
Honduras	5.6	3.6	64.3	2.6	46.4
India	546.5	347.0	63.5	257.9	47.2
Iran	87.7	25.7	29.3	12.4	14.1
Israel	106.4	41.1	38.6	24.2	22.7
Kenya	25.4	14.2	55.9	10.2	40.1
Mexico	567.5	123.4	21.7	39.1	6.9
Nicaragua	13.9	6.9	49.6	4.7	33.8
Nigeria	251.7	106.0	42.1	66.9	26.6
Pakistan	667.4	461.4	69.1	350.8	52.6
Panama	26.4	13.1	49.6	8.8	33.3
Paraguay	16.6	9.9	59.6	7.1	42.8
Peru	153.4	57.9	37.7	33.9	22.1
Philippines	100.7	31.7	31.5	16.2	16.1
Southern Rhodesia	3.9	1.6	41.0	1.0	25.6
Tanzania	25.8	18.3	70.9	14.0	54.3
Thailand	24.5	10.1	41.2	6.2	25.3
Uganda	0.9	0.5	55.5	0.4	44.4
Uruguay	96.3	26.9	27.9	12.1	12.6
Venezuela	70.8	24.7	34.9	13.8	19.5
Zambia	7.3	2.8	38.4	1.8	24.7

Sources: Tables 6 and 8 above.

NOTE: Computations assume that tied lending imposes a 15 per cent cost on the borrower, and that recipient's return on domestic investment is 12 per cent.

TABLE 10

Thirty-three developing countries' official borrowing commitments, 1965, compared to grant equivalents under tied and untied aid

Country	Nominal value of loans ($US million)	Grant equivalent: Untied loans: $US million	Untied loans: Percentage of nominal	Tied loans: $US million	Tied loans: Percentage of nominal
Argentina	221.4	48.1	21.7	14.7	66.6
Chile	179.3	96.9	54.0	67.8	37.8
China (Taiwan)	110.5	38.9	35.2	21.8	19.7
Costa Rica	19.3	9.6	49.7	6.5	33.7
Dominican Republic	22.1	11.5	52.0	7.9	35.7
Ecuador	17.7	6.2	35.0	3.5	19.8
El Salvador	6.3	3.9	61.9	2.8	44.4
Ethiopia	24.1	10.0	41.5	6.2	25.7
Guatemala	4.7	3.9	83.0	3.1	66.0
Guyana	7.8	5.3	67.9	4.0	51.3
Honduras	18.3	12.1	66.1	9.1	49.7
India	710.0	451.2	63.6	334.7	47.1
Jamaica	19.6	8.0	40.8	5.0	25.5
Kenya	57.6	27.7	39.4	15.8	27.4
Korea, Republic of	122.6	76.7	62.6	56.4	46.0
Madagascar	0.4	0.2	50.0	0.1	25.0
Malaysia	73.7	28.1	38.1	16.7	22.7
Morocco	110.4	54.2	49.1	36.2	32.8
Nicaragua	17.0	8.9	52.4	6.2	36.5
Nigeria	117.3	73.2	62.4	53.8	45.9
Pakistan	262.6	158.0	60.2	114.7	43.7
Paraguay	14.1	4.6	32.6	2.4	17.0
Peru	136.0	45.6	33.5	24.7	18.2
Philippines	146.4	25.2	17.2	3.5	2.4
Senegal	10.8	5.7	52.8	3.9	36.1
Southern Rhodesia	7.0	...	...	...	...
Sudan	62.5	28.0	44.8	18.0	28.8
Tanzania	5.0	2.0	40.0	1.2	24.0
Thailand	35.6	18.4	51.7	12.6	35.4
Trinidad and Tobago	4.0	1.4	35.0	0.8	20.0
Uganda	14.1	6.7	47.5	4.4	31.2
Uruguay	24.3	6.9	28.3	3.2	13.2
Venezuela	82.5	24.3	29.5	11.7	14.2

Sources: Tables 6 and 8 above.
NOTE: For assumptions, see note to table 9 above.

(Uruguay and Dominican Republic). In 1965, the difference between nominal and effective rates under the same assumption varied from 31 per cent (Nigeria) to 90 per cent (Philippines). In all years, of course, the effective/nominal interest ratio was lower under the 10 per cent tying cost assumption and higher when a 20 per cent cost was assumed.

(e) The margin of effective rates over nominal rates depends on four factors:

(i) The cost of tying to the recipient per dollar borrowed;

(ii) The length of the amortization period;

(iii) The nominal rate of interest;

(iv) The length of the grace period.

The first two factors normally exercise the greatest effect.

63. A corollary of the fact that effective interest rates on tied loans exceed nominal rates is that "effective" grant equivalents for tied aid are less than "nominal" or untied grant equivalents from the recipient's viewpoint. Tables 9 and 10 show the differences at the 12 per cent discount rate for 1964 and 1965. In the aggregate, the results for the recipient countries compare as follows:

Combined value of borrowings, recipient countries, under tied and untied loans, 1964 and 1965

($US million)

Year	Nominal value	Untied grant equivalent	Tied grant equivalent
1964	3,355.0	1,592.3	1,061.3
	(100.0)	(47.5)	(31.6)
1965	2,665.0	1,302.1	863.4
	(100.0)	(48.9)	(32.3)

NOTE: Figures in parentheses show percentage of nominal value.

64. In other words, if the thirty-nine countries paid an average of 15 per cent above world prices for goods purchased through official borrowings in 1964 and 1965, the grant equivalent would have been reduced by one third. As in the cases of untied borrowing, there is substantial variation among countries. In 1964, for example, grant equivalents were reduced by more than half for the Dominican Republic and Uruguay and by only about one fifth in the case of Tanzania. The weighted average of one third reduction in grant equivalent reflects a comparable margin between nominal and effective interest rates under tied aid.

65. These computations of recipients' grant equivalents, both tied and untied, should be considered as illustrative in nature. The reasons for caution in interpreting the results have been stated or implied in the foregoing discussion: *(a)* uncertainty about appropriate domestic discount rates; *(b)* uncertainties about differences in tied aid proportions among countries (in terms both of nominal tying imposed and of the degree to which recipients are able to avoid costs of tying by manipulating their import choices); *(c)* uncertainties about the extent to which the weighted average terms reflect various kinds of loans (for example, suppose we are considering the alternative of IBRD borrowing for a country, and we find it would offer no advantage over current terms in the grant-equivalent sense; this may merely mean that the recipient was in fact doing most of its borrowing from IBRD, so that the grant equivalent of the IBRD "alternative" was necessarily zero); *(d)* the degree of aid-tying practiced by major donors, notably the United States, undoubtedly increased between 1960 and 1965, so that the computations in tables 9 and 10 would, in a more detailed analysis, show different extents of tying in each year.

66. Finally, it is important to note that no allowance has been made for foreign exchange shortages in the calculations of recipients' grant equivalents. The inflow of resources may be used to increase domestic production but may not result in increased exports or effective import substitution. That is, it may not generate capacity to repay in foreign exchange, or, if such capacity is generated, trade policies in importing countries or exchange rate policies in the exporting country may impede the realization of increased foreign exchange earnings. In practice, it might therefore well be the case that the sacrifice of foreign exchange would involve a greater opportunity cost than would the sacrifice of domestic resources.

Policy implications

67. The analysis outlined in this study leads to certain implications for aid policy. Firstly, it demonstrates clearly that, even within current budgeted levels for official aid, the benefit to recipients could be substantially increased. For example, in 1966 the gross official foreign aid commitment of fourteen donor countries was $8.7 billion while the real cost of this aid, discounted at domestic rates, was $6.1 billion. The benefit of that aid to recipients was somewhat higher, at least if we accept the proposition that rates of return are higher in recipient countries than in donor countries. In any event, however, if more of the $8.7 billion had been offered in the form of grants, the value to recipients would have been substantially greater.

68. Within the loan category, a shift to longer-term loans and lower rates of interest would have a similar effect. For example, in 1964, Honduras borrowed at an average interest rate of 2.1 per cent and an average term of 21.7 years, with a consequent grant equivalent of 64.3 per cent of nominal value of borrowings. In the same year, Costa Rica's average borrowing rate and term were 5.6 per cent and 8.6 years, leading to a grant equivalent of only 3.4 per cent. This recipients' benefit calculation is equivalent, in debt-service terms, to demonstrating a far more onerous debt-service burden per dollar borrowed for Costa Rica than for Honduras in that year. The real cost and benefit analysis leads to the same conclusion as recent analysis of debt-service problems. The conclusions of the two types of analysis are in accord because debt-service obligations per unit value of aid received increased commensurately with the decline in grant equivalent per unit value of aid offered. Thus, real cost and benefit considerations and debt-service considerations combine to provide a single argument for easing aid terms and conditions.

69. Naturally, a shift to softer aid terms increases the real cost to the donor. Whether this increase is greater or smaller than the increase in benefit to the recipient depends in pure theory on the rate of return to capital in the two countries. If it is higher in the donor country its cost increase from softer lending is greater per dollar of aid than the increase in the recipients' benefit. If the return to capital is higher in the recipient country than in the donor country, then the donor's cost increase per dollar of aid is less than the recipient's benefit increase.[15]

70. However, this theoretical approach to real cost and debt service problems neglects a major element. The basic test of appropriate grant equivalent ratios or—what amounts over time to the same thing—appropriate debt service levels, is not the relative return to capital in donor and recipient countries, but the general economic situation of donor and recipient. As Ohlin has said:

> "It might well be argued that a country that qualifies for foreign assistance has no debt servicing capacity at all. Debt service competes with essential imports for foreign exchange earnings which are regarded as insufficient, and with investment needs for inadequate [domestic] savings. When debt is serviced in such a situation, it is in recognition of the fact that fulfilment of obligations is a prerequisite for further assistance, but no one expects a country in this position to liquidate its external debts."[16]

Looked at in this way, the case for raising the donors' grant equivalent per dollar of capital transfer becomes overwhelming. This point has been brought home recently

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[15] Cf. Wilson Schmidt, "The Economics of Charity: Loans versus Grants", *The Journal of Political Economy*, vol. LXXII, no. 4 (August 1964), pp. 387-395.

[16] Goran Ohlin, *Foreign Aid Policies Reconsidered* (Paris, Development Centre of OECD, 1966) p. 88.

by the evident inability of some under-developed countries to repay conveniently their accumulated debts. As Ohlin has pointed out, when net lending continues at the rate of several billion dollars annually, international aid is sure to produce a debt of colossal magnitude, which may in itself discourage further lending.

71. A second set of policy implications arising from the analysis of this report is the significance of aid-tying for donors and recipients. For donors, as we have seen, the principal issues are balance-of-payments effect and the creation of long-term markets for output. The real cost savings to donors stemming from aid-tying under full employment conditions are probably small.

72. For recipients, on the other hand, the real value of aid, particularly in the form of loans, may be substantially reduced by requirements for tying. This is the more likely to be true as the recipient finds it difficult to shift its foreign spending to compensate for the tying requirement. Naturally, if the alternative to tied aid is no aid, the recipient may still be better off if he accepts the high effective interest rates implicit in tied loans. However, it may often be the case that recipients are unaware of the increased burden of repayment effectively imposed on them by tied lending. One way to make this effect explicit would be for UNCTAD or other international organizations to publish a handbook which would specify the effective repayment schedules imposed by different terms and conditions of lending, tied and untied. It is clear, for example, from the computations of table 8 that the effective rate of interest on tied lending is significantly higher than the apparent rate. The differences between the two rates are in some instances perhaps so large that, if made explicit, borrowers might prefer to switch their capital sources to untied lending, even at high nominal rates of interest.

73. A third set of policy implications relates to burden-sharing questions. The foregoing analysis leads to the conclusion that some form of grant element approach is more appropriate than the unweighted summing of grants and loans, as a method for comparing the aid efforts of donor nations. This type of analysis also clarified the role of private investment in burden-sharing computations. As a general rule, private investment, except to the extent that it includes a subsidy from the donor Government, should not be included as a real cost to donors. Therefore, it cannot be weighed in the same scales as official aid for burden-sharing purposes.

74. Fourthly, there are clearly a number of policy aspects, both for burden-sharing considerations and for considerations of total capital flows, that cannot be effectively measured by the methods used in this report. The grant equivalent of resource flows is of little value for considering balance-of-payments problems which often affect donors' and recipients' policies towards both official and private capital flows. Nor does it enable policymakers to distinguish among the genuinely qualitative effects of aid, including such complex economic problems as the relative productivity of various forms of aid and of aid from various donors, as well as the relative ability of recipients to make use of the various forms of resource flows.

75. Within the sphere of its usefulness, the grant-equivalent approach is still far from an accurate tool, particularly for assessing recipients' benefits, for reasons that have been discussed above. Any effort to improve its precision should include from the donors' side: improved estimates of domestic interest rates; estimates, for each donor's tied aid, of the difference between aid prices and export prices; and data on terms and conditions of the flow of lending, in addition to those now available on the terms and conditions of loan commitments. For recipients, the list includes domestic rates of return, margins between prices paid for tied aid and world market prices and rates of return on foreign private investment.

76. Fifthly, the data presented above on donors' cost confirms the results of earlier studies.[17] The real cost of resource flows to donors is less than the official data on resource flows implies. The tendency of donors to offer more favourable loan terms and conditions during the period reviewed above has led, in combination with rising domestic interest rates, to some increase in the ratio of grant equivalents to nominal aid commitments. In terms of official lending alone, this tendency was particularly marked from 1961 to 1964, with some decline in grant-equivalent ratios occurring in 1965. Tables 2 and 3 demonstrate this trend. This increase in grant-equivalent ratios was offset by two factors during the period: increased aid-tying and an increase in the ratio of loans to grants from 1961 to 1964 inclusive.

77. Sixthly, on the recipients' side, the data presented in tables 6 to 10 bring out several points for the thirty-nine countries analysed:

(a) There was a marked general increase in the grant equivalent of official borrowing between 1960 and 1965;

(b) Differences in grant equivalent among countries bear some relation to estimates of current and prospective ability to repay foreign debt. Thus, the 1965 grant-equivalent ratios for Pakistan and India are high, while Mexican and Venezuelan borrowings show a low grant equivalent. However, in a number of cases, there seems to be little association between repayment prospects and terms. These cases presumably reflect the fact that terms of official borrowings from private sources are likely to be inversely related to repayment prospects. Countries with stringent limitations on foreign-exchange resources often have to borrow under more onerous terms on that account.

(c) The stated terms and conditions of loans are not necessarily a good guide to recipients' benefits. The costs imposed by aid-tying affect the real resource cost to a major extent. Depending on the terms and conditions of loans, a recipient Government may be better off if it negotiates an untied IBRD loan at 6 per cent interest than a 3.6 per cent loan (the average DAC bilateral lending rate in 1965), where procurement is tied to purchases of goods that are priced significantly above world market levels.

[17] John A. Pincus, *op. cit.*, Goran Ohlin, *op. cit.*, I.M.D. Little and J. Clifford, *International Aid* (London, George Allen and Unwin Ltd., 1965).

ANNEX

This annex sets forth the methods and sources used to compute aid costs and benefits. Present value of loan commitment was computed on the basis of weighted average loan terms and conditions. Tables A-1 to A-5 show nominal value of aid commitments, compared to real cost of commitments for each of fourteen DAC countries for the years 1962-1966.

I. Sources

A. *Donor's commitments*

1. *Commitments in cash*

(a) 1962 — loan and grant commitments from OECD, *1965 Review, op. cit.*, weighted average interest rates and maturities on loans: *ibid.*, weighted average grace periods on loans, sources cited in J. Pincus, *op. cit.* chap. 5;

(b) 1963 and 1964 — loan and grant commitments from OECD, *1965 Review, op. cit.*, weighted average interest rates, maturities and grace periods, from OECD, *1966 Review, op. cit.*;

(c) 1965 — loan and grant commitments and weighted average interest rates, maturities and grace periods, from OECD, *op. cit.*, and national sources;

(d) 1966 — loan and grant commitments and weighted average interest rates, maturities and grace periods, from OECD, *Development Assistance Efforts and Policies, 1967 Review* (Paris, 1967).

2. *Commitments in kind*

(a) This consists of contributions of farm products under United States Public Law 480, titles I, II, III, and IV. Title IV loans are dollar-repayable and were included in the weighted averages for each year in the same manner as other loans.

(b) Grants under titles II and III are valued by the United States Government at Commodity Credit Corporation (CCC) costs, including storage and interest charges. The grant equivalent computations value them at world market prices, as follows, in millions of dollars:

Year	Title II		Title III	
	CCC cost	Market value	CCC cost	Market value
1962	239.3	108.0	251.0	181.7
1963	194.5	82.1	292.2	179.5
1964	146.6	74.5	264.6	221.8
1965	203.5	117.5	174.1	160.1
1966	168.1	104.3	155.0	133.0

These data are taken from *Food for Peace, Annual Report on Activities Carried out under Public Law 480, 83rd Congress, as Amended*, (Washington, D. C., United States Government Printing Office), an annual report to Congress. The published figures for title III in the 1964 annual report are in error. The figures shown above are corrected figures supplied by the United States Department of Agriculture, Foreign Agriculture Service.

(c) Title I is valued at world market prices, as reported in *Food for Peace, op. cit.*, less the value of sales proceeds to be retained for United States official uses. These commitments and retained sales proceeds were, in millions of dollars:

Year	Value commitment at market prices	Value of retained proceeds	Net commitment	Commitment as reported to DAC
1962	1,271.0	184.3	1,086.7	1,209.0
1963	470.3	122.7	347.6	827.0
1964	923.5	190.3	733.2	1,416.0
1965	317.8	64.8	253.0	308.0
1966	1,033.7	206.7	827.0	824.9

This method is different from the one used by the United States Government in reporting to DAC (in the last column above), and thereby produces higher figures for 1962 and 1966 than does the United States submission to DAC, and lower figures for subsequent years.

B. *Donors' domestic discount rates*

These are taken from IMF, *International Financial Statistics*, long-term bond rate plus 1 per cent or, in some cases, reported figures for mortgage rates. IBRD borrowing rate averages supplied by IBRD.

C. *Recipients' borrowing commitments*

Figures for 1960, 1964 and 1965 (including terms and conditions) from IBRD/IDA, *Annual Report 1965-1966* and *Annual Report 1966-1967, op. cit.*

D. *Recipients' discount rates*

For the thirty-nine country sample (text tables 6 and 8) these are based on IBRD lending rates and hypothetical rates for suppliers' credits and domestic return to capital. Discount rates for the fourteen-country sample (table 7) taken from IBRD, " Prices and yields of selected external government bonds in various markets ", *op. cit.*

II. Methods

The donor's grant equivalent was computed by two different methods. The first, on which tables A-1 to A-5 inclusive are based, computed grant equivalents $[L - (P_1+P)]$ as follows:

$$(a)\quad P_1 = \int_0^G i L e^{-qt}\,dt = \frac{i}{q} L(1-e^{-qG})$$

$$(b)\quad P_2 = \int_G^T \left[\frac{L}{T-G} + i L\left(1-\frac{t-G}{T-G}\right)\right] e^{-qt}\,dt$$

$$(c)\quad = \frac{i}{q} L e^{-qG} + \left(1-\frac{i}{q}\right) L \frac{e^{-qG}-e^{-qT}}{q(T-G)}$$

where:

L = Face value of loan

P_1 = Present value of interest payments during grace period

P_2 = Present value of interest and amortization payments after grace period

$P\ (= P_1 + P_2)$ = Present value of loan repayments

S = $L - P$ = Grant equivalent of loan

i = Rate of interest

q = Rate of discount

T = Maturity

G = Grace period

Using this approach, as set forth by Ohlin[a], implies that the principal is repaid in equal instalments. However, repayment of

[a] Goran Ohlin, *op. cit.* pp. 101-103.

loans is often made on the basis of equal periodic payments of interest and principal (on the annuity principle). Therefore, the same OECD data were also used to compute P_1 and P_2 according to annuity formulae:

$$(d)\ P_1 = \int_0^G i\,L\,e^{-qt}\,dt = \frac{i}{q}L(1-e^{-qG})$$

$$(e)\ P_2 = \int_G^T \frac{L\,i}{1-e^{-i(T-G)}}e^{-qt}\,dt$$

$$= L\frac{i}{q}\left[\frac{e^{-qG}-e^{-qT}}{1-e^{-i(T-G)}}\right]$$

Using *(d)* and *(e)*, grant equivalents (S) were generally higher than when computed under formulae *(a)* and *(c)*. This results from the fact that periodic payments decline over the life of the loan in formula *(c)*, while they remain constant in formula *(e)*. Since near-term repayments have a higher present value to the lender than deferred repayments, the grant equivalent (L-P) will be higher when repayments are made in equal instalments of interest and principal. Table A-6 gives donor's grant-equivalent ratios of official lending commitments for the period 1962-1965, when the annuity method is used. When table A-6 is compared with table 1 in the text, it is clear that grant equivalents are uniformly somewhat higher, but the differences are small, amounting to less than 1 per cent of the face value of loans.

The recipient's grant equivalent shown in text tables 6 and 7 was also computed according to formulae *(a)* and *(c)*, at the various rates of discount.

For computing the tied-aid grant equivalents of tables 9 and 10, it was necessary to compute the effective interest rates, i′. In principle, the problem is one of solving the equation:

$$(f)\ g\,L = \int_0^T A_t\,e^{-i't}\,dt$$

Where A_t = Li, during the grace period; t = o, G

and $A_t = \frac{L\,i}{1-e^{-i(T-G)}}$ during the amortization period t = G to T

and g is a coefficient of less than unity, indicating the ratio of world prices to tied aid prices. After solving for i′, formulae *(a)* and *(c)* and formulae *(d)* and *(e)* are recomputed, substituting i′ for i in the formulae to find $P'_1+P'_2$ (=P), the "effective" present value of tied borrowings.

Formula *(f)* is based on the annuity principle, and i′ was solved using Newton's iterative methods.

TABLE A-1

DAC members' official aid commitments compared to real cost of commitments, 1962

($US million)

Country[a]	Grants to multilateral agencies	Official bilateral commitment: Grants	Official bilateral commitment: Loans	Total	Real cost discounted at: Domestic rate[b]	IBRD borrowing rate (4.1%)	Private investment rate (10.0%)
Australia	5.7	68.1	—	73.8	73.8	73.8	73.8
Austria	1.7	0.6	5.8	8.1	2.3 (7.0%)	2.0	2.8
Belgium	15.2	65.6	—	80.8	80.8	80.8	80.8
Canada	12.5	47.3	14.0	73.8	59.9 (6.1%)	58.1	62.6
Denmark	6.8	0.8	—	7.6	7.6	7.6	7.6
France	115.2	756.7	142.8	1,014.7	891.2 (6.0%)	873.0	920.1
Germany (Federal Republic)	105.4	155.3	315.0	575.4	319.3 (6.9%)	256.1	372.2
Italy	19.6	18.8	112.4	150.8	39.1 (6.3%)	31.3	50.7
Japan	8.7	103.9	17.5	130.1	113.8 (7.6%)	111.0	115.4
Netherlands	44.1	11.4	10.1	65.6	56.7 (5.2%)	55.6	59.8
Norway	6.1	4.4	—	10.5	10.5	10.5	10.5
Portugal	—	3.1	39.4	42.5	6.4 (5.0%)	3.4	18.3
United Kingdom	40.6	221.2	356.5	618.3	298.5 (7.0%)	198.7	369.1
United States	273.0	1,879.0[c]	1,701.0	3,853.0[c]	2,422.3[c] (5.0%)	2,275.0[c]	2,946.8[c]
Total	654.6	3,336.2[c]	2,714.5	6,705.3[c]	4,382.2[c]	4,036.9[c]	5,090.5[c]

Sources: Official commitments and loan terms and conditions from OECD, *The Flow of Financial resources to less-developed Countries, 1961-1965, op. cit., 1965 Review, op. cit., 1967 Review, op. cit.*, Methods of real cost computation described in this annex.

[a] Australia, Belgium, France and Portugal on gross disbursements basis. Multilateral grants on disbursement basis. United States real cost results reduced by $201.6 million to allow for overstatement of Public Law 480, title II and title III donations.

[b] Each country's domestic rate shown in parentheses.

[c] Plus $1086.7 million net total Public Law 480, title I, United States, as further explained in this annex.

TABLE A-2

DAC members' official aid commitments compared to real cost of commitments, 1963

($US million)

Country [a]	Grants to multilateral agencies	Official bilateral commitment		Total	Real cost discounted at:		
		Grants	Loans		Domestic rate [b]	IBRD borrowing rate (4.1%)	Private investment rate (10.0%)
Australia	17.5	78.4	—	95.9	95.9	95.9	95.9
Austria	1.6	—	0.9	2.5	1.8 (7.0%)	1.7	2.0
Belgium	16.5	75.8	—	92.3	92.3	92.3	92.3
Canada	18.1	43.6	81.6	143.3	62.3 (6.1%)	49.8	80.4
Denmark	5.3	6.8	—	12.1	12.1	12.1	12.1
France	30.3	678.5	173.9	882.7	728.8 (6.0%)	706.4	763.5
Germany (Federal Republic)	23.3	160.5	523.2	707.0	281.1 (6.6%)	172.2	383.6
Italy	2.8	14.0	140.3	157.1	18.6 (6.4%)	3.5	37.8
Japan	9.4	80.1	135.0	224.5	99.1 (6.8%)	69.7	124.5
Netherlands	39.3	8.5	21.3	69.1	48.6 (5.2%)	46.1	55.4
Norway	7.5	3.2	—	10.7	10.7	10.7	10.7
Portugal	0.1	8.8	44.7	53.6	16.2 (5.2%)	11.8	28.7
United Kingdom	38.8	234.6	240.7	514.1	308.8 (6.6%)	255.0	358.4
United States	112.0	1,535.0 [c]	1,515.6	3,162.6 [c]	1,989.0 [c] (5.0%)	1,828.4 [c]	2,429.5 [c]
Total	322.5	2,927.8 [c]	2,877.2	6,127.5 [c]	3,765.3 [c]	3,355.6 [c]	4,472.8 [c]

Sources: See table A-1.

[a] Australia, Belgium and France on gross disbursements basis. United States real cost results reduced by $225.1 million to allow for overstatement of Public Law 480, title II and title III donations.

[b] Each country's domestic rate shown in parentheses.

[c] Plus $347.6 million net total Public Law 480, title I, United States, as further explained in this annex.

TABLE A-3

DAC members' official aid commitments compared to real cost of commitments, 1964

($US million)

Country[a]	Grants to multilateral agencies	Official bilateral commitment: Grants	Official bilateral commitment: Loans	Total	Real cost discounted at: Domestic rate[b]	Real cost discounted at: IBRD borrowing rate (4.2%)	Real cost discounted at: Private investment rate (10.0%)
Australia	11.0	93.0	—	104.0	104.0	104.0	104.0
Austria	2.4	1.8	16.1	20.3	5.4 (7.0%)	3.5	7.2
Belgium	2.0	76.8	2.4	81.2	79.5 (6.6%)	79.1	79.9
Canada	18.5	68.5	84.2	171.2	98.8 (6.2%)	82.5	120.0
Denmark	9.0	2.8	3.5	15.3	12.7 (7.2%)	11.9	13.2
France	16.8	864.2	279.8	1,160.8	937.0 (6.1%)	902.2	891.6
Germany (Federal Republic)	84.3	188.9	279.2	552.4	331.0 (6.7%)	278.2	382.1
Italy	80.9	23.6	131.5	236.0	121.6 (7.3%)	103.9	134.7
Japan	17.0	76.0	90.0	183.0	104.2 (7.6%)	81.2	116.5
Netherlands	36.6	25.2	20.4	82.2	65.5 (5.9%)	62.4	70.5
Norway	7.6	1.5	0.5	9.6	9.1 (5.6%)	9.1	9.3
Portugal	0.2	7.5	35.5	43.2	9.7 (4.9%)	8.0	19.2
United Kingdom	51.0	384.7	365.8	801.4	538.5 (7.0%)	450.5	601.9
United States	253.0	1,594.0[c]	2,373.0	4,220.0[c]	2,490.8[c] (5.2%)	2,273.6[c]	3,226.7[c]
Total	590.3	3,408.5[c]	3,681.9	7,680.6[c]	4,907.8[c]	4,450.1[c]	5,886.8[c]

Sources: see table A-1.

[a] Australia and Belgium (grants only) on gross disbursements basis. United States real cost results reduced by $114.0 million to allow for overstatement of Public Law 480, titles II and III donations.

[b] Each country's domestic rate shown in parentheses.

[c] Plus $733.2 million net total, title I, Public Law 480, United States as further explained in this annex.

TABLE A-4

DAC members' official aid commitments compared to real cost of commitments, 1965

($US million)

Country [a]	*Grants to multilateral agencies*	*Official bilateral commitment*		*Total*	*Real cost discounted at:*		
		Grants	*Loans*		*Domestic rate* [b]	*IBRD borrowing rate (4.6%)*	*Private investment rate (10.0%)*
Australia	19.8	130.0	—	149.8	149.8	149.8	149.8
Austria	3.2	2.6	36.1	41.9	6.5 (6.0%)	4.6	11.3
Belgium	8.8	101.5	2.1	112.4	110.8 (6.6%)	110.6	111.2
Canada	25.3	104.7	110.4	240.4	163.3 (6.2%)	146.4	189.3
Denmark	11.4	2.8	6.0	20.2	15.2 (8.4%)	13.9	15.7
France	27.4	820.1	213.9	1,061.4	882.0 (6.0%)	861.0	927.8
Germany (Federal Republic)	100.4	190.0	391.5	681.9	390.5 (8.0%)	302.9	429.9
Italy	44.7	23.7	257.8	326.2	87.3 (6.7%)	70.9	110.4
Japan	48.9	69.3	199.3	317.5	140.7 (6.5%)	120.5	171.4
Netherlands	30.9	47.6	32.3	110.8	86.3 (6.2%)	82.0	93.4
Norway	9.5	4.0	0.6	14.1	13.6 (5.7%)	13.6	13.8
Portugal	2.2	7.3	23.6	33.1	11.9 (4.9%)	11.2	19.4
United Kingdom	52.4	218.2	219.2	489.8	344.2 (7.4%)	298.4	374.4
United States	471.2	1,690.7 [c]	1,534.2	3,696.1	2,699.5 [c] (5.3%)	2,596.3 [c]	3,168.2 [c]
Total	856.1	3,412.5 [c]	3,027.0	7,298.1	5,101.6 [c]	4,782.1 [c]	5,786.0 [c]

Sources: see table A-1.

[a] Australia on gross disbursements basis; Belgium bilateral grants on gross disbursement basis; United States real cost results reduced by $100 million to allow for overstatement of Public Law 480, titles II and III donations.

[b] Each country's domestic discount rate shown in parentheses.

[c] Plus $253.0 million net total, Public Law 480, title I, United States, as further explained in this annex.

TABLE A-5

DAC members' official aid commitments compared to real cost of commitments, 1966

($US million)

Country [a]	Grants to multilateral agencies	Official bilateral commitment: Grants	Official bilateral commitment: Loans	Total	Real cost discounted at: Domestic rate [b]	Real cost discounted at: IBRD borrowing rate (5.6%)	Real cost discounted at: Private investment rate (10.0%)
Australia	18.0	136.2	—	154.2	154.2	154.2	154.2
Austria	4.9	3.8	76.9	85.7	9.5 (5.5%)	9.7	19.4
Belgium	16.0	76.6	5.6	98.2	94.1 (6.8%)	93.8	95.0
Canada	30.6	161.0	57.3	248.9	217.7 (6.7%)	212.9	227.6
Denmark	18.7	3.8	13.5	36.0	30.8 (8.9%)	28.7	31.3
France	40.9	793.0	175.5	1,009.4	865.9 (6.4%)	857.6	896.6
Germany (Federal Republic)	131.7	124.2	354.6	610.5	386.1 (7.9%)	330.6	424.8
Italy	44.1	22.9	432.2	499.2	116.5 (6.8%)	98.2	160.1
Japan	38.5	107.1	205.5	351.1	170.9 (7.0%)	151.6	205.0
Netherlands [c]	30.9	47.6	32.3	110.8	88.5 (7.2%)	84.8	93.4
Norway	9.9	5.9	—	15.8	15.8	15.8	15.8
Portugal [c]	2.2	7.3	23.6	33.1	11.9 (4.9%)	13.2	19.4
United Kingdom	55.1	195.9	254.6	505.6	398.0 (7.8%)	365.8	421.6
United States	494.5	1,712.9 [d]	1,922.3	4,129.7 [c]	2,681.5 [d] (5.7%)	2,675.0 [d]	3,182.5 [d]
Total	936.0	3,398.2 [d]	3,553.9	7,888.2 [c]	5,241.4 [d]	5,091.9 [d]	5,946.7 [d]

Sources: see table A-1.

[a] Australian and Belgian bilateral grants on gross disbursements basis. Portugal and Netherlands, estimated. United States real cost results reduced by $100 million to allow for overstatement of Public Law 480, title II and title III donations.

[b] Each country's domestic discount rate shown in parentheses.

[c] Estimated.

[d] Plus $827.0 million net total Public Law 480, title I, United States, as further explained in annex.

TABLE A-6

Grant elements in DAC donors' official lending commitments 1962-1965, discounted by annuity method (Loans discounted at donors' domestic interest rate)

Country	*Grant element as percentage of official loan commitment*			
	1962	*1963*	*1964*	*1965*
Australia	[a]	[a]	[a]	[a]
Austria	[a]	23.0	7.9	5.7
Belgium	[a]	19.5	15.0	5.6
Canada	0.6	0.7	15.1	26.4
Denmark	[a]	[a]	26.5	20.0
France	14.4	12.2	20.9	16.8
Germany (Federal Republic)	18.2	18.8	22.3	26.4
Italy	0.6	1.3	12.0	9.7
Japan	5.1	6.8	9.6	12.4
Netherlands	12.7	4.0	19.2	25.6
Norway	[a]	45.4	[a]	22.8
Portugal	8.8	17.1	9.3	10.7
United Kingdom	11.2	15.6	28.9	35.2
United States	28.9	37.8	34.2	22.8

Source: see text of annex.
[a] No loan commitments.

III. A REVIEW OF THE GRANT-EQUIVALENT METHOD

The grant-equivalent method used in this report is based on official commitments. If appropriate data were available, a more accurate method would be to compute grant equivalents on the basis of actual cash outflows, loan by loan, and actual repayment schedules, loan by loan, including allowance for refinancing when appropriate. Computations based on cash flows might produce different results from those based on commitments and weighted averages of loan terms on a hypothetical repayment schedule. An earlier study, on a commitment basis, but including computation of grant equivalents on a loan by loan basis, using contractual repayment schedules, emerged with slight differences from the results of this study for the year 1962.[b]

The calculation of grant equivalents on the cash-flow basis awaits an improved system of data collection for official capital transfers, such as that initiated by IBRD in 1967.

The method used in the present study has been adopted in other analyses.[c] Other writers have commented on the method, without applying it.[d] Another line of inquiry has investigated the logical implication of maximizing behaviour for capital transfers.[e]

The other computational efforts have emerged with results similar to the analysis of this report. Ohlin (*op. cit.* p. 73) shows somewhat lower grant-equivalent ratios than this report. This reflects the fact that he did not take account of grace periods in his computations and used a uniform discount rate of 6 per cent. His estimate for real cost of aid commitments for 1963 is also less than that estimated in this report ($4.2 billion as compared to $3.7 billion above), presumably attributable to same differences in the method of calculation and also to: *(a)* the use of net flows rather than commitments; *(b)* the effects of subsequent revisions in DAC data for 1963; and *(c)* the differences in valuation methods for Public Law 480.

Little and Clifford have also estimated the real cost of aid in 1963. Their estimates were developed, like Ohlin's, by applying a single interest rate to all countries. Their estimate (when Public Law 480 is valued at reported values) is higher than Ohlin's at the 6 per cent discount rate and higher than this report at the domestic discount rate because they have based their calculations on gross aid flows, a different value from Ohlin's net flows or this report's commitments basis; and also because neither of their alternative methods of valuing Public Law 480 corresponds to that used by Ohlin. Furthermore, they have included grace period calculations of one year and five years in their estimates, instead of actual weighted averages, as above, or no grace period, as in Ohlin's estimate.

The OECD report, *The flow of financial resources to Less-Developed Countries 1961-1965* includes grant-equivalent calculations for the years 1964 and 1965. Its estimates, like those in this report, are based on aid commitments, using a domestic discount rate which is about 1 per cent less than the discount rates used in this report. Its method of discounting uses Ohlin's continuous formula, as in this report, but modifies it for short-period loans and for loans with abnormal repayment schedules.

A comparison of the five estimates gives the following results for the grant-equivalent of loans:

[b] See J. Pincus, *op. cit.*, chap. 5.

[c] Ohlin, *op. cit.*; I. M. D. Little and J. M. Clifford, *op. cit.*; OECD, *The Flow of Financial Resources to Less-Developed Countries, 1961-1965,* op. cit.; IBRD, "Grant element Calculations," unpublished memorandum, 1967; H. G. Johnson, *Economic Policies Toward Less-Developed Countries* (Washington, D.C., Brookings Institution, 1967).

[d] United Nations, Department of Economic and Social Affairs, *Measurement of the Flow of Resources to Developing Countries: a report on methodological problems by a group of experts appointed by the Secretary-General* (United Nations publication, Sales No.: 67.II.D.17); Jacob Kaplan, *The Challenge of Foreign Aid* (New York, Praeger, 1967).

[e] Richard Cooper, *A Note on Foreign Assistance and the Capital Requirements for Development* (Santa Monica, The Rand Corporation, RM-4291-PR, February 1965); and Wilson Schmidt, *op. cit.*

Grant equivalent of DAC bilateral official loans, discounted at domestic interest rate

($US million — percentage of nominal in parentheses)

Method	1962		1963		1964		1965	
	Nominal	Grant equivalent	Nominal	Grant equivalent	Nominal	Grant equivalent	Nominal	Grant equivalent
Ohlin [a] . .	1,890	358	2,230	430				
(1966) . .		(19%)		(19%)				
Little and								
Clifford [b].			2,082	(i) 537				
(1965) . .				(25.7%)				
				(ii) 598				
				(28.7%)				
OECD [c] . .					3,267	784	3,035	448
(1967) . .						(21.6%)		(14.8%)
Pincus [d] . .	2,715	590	2,877	726			3,027	624
(1967) . .		(21.7%)		(25.2%)	3,682	1,050		(20.6%)
						(28.5%)		
Pincus [e] . .	2,960	516						
(1963) . .		(17.4%)						

[a] Ohlin, *op. cit.* p. 73. Nominal aid based on net flows; formulae *(a)* and *(b)* of this annex used for discount; no grace period; average interest and maturities for all countries combined; 6 per cent discount rate. Data source unspecified (possibly OECD, *Development Assistance Efforts and Policies, 1964 Review*, Paris 1964).

[b] Little and Clifford, *op. cit.* p. 75. Nominal aid based on gross flows; formulae *(d)* and *(e)* of this annex used for discount; estimate (i) one-year grace period, estimate (ii), five-year grace period; average interest rate and maturity for each country; 6 per cent discount. Data source, OECD, *1964 Review, op. cit.*

[c] OECD, *Flow of Financial Resources to Developing Countries 1961-1965, op. cit.* p. 142. Nominal aid based on commitments; formulae *(a)* and *(b)* used for discounting most loans, actual repayment schedule for others; loans discounted loan by loan with actual grace period, maturities and interest rates; discounted at government bond rate. Data source unspecified (presumably DAC records).

[d] Nominal aid based on commitments; formulae *(a)* and *(b)* used for discounting (also annuity formulae, not shown above, in table A-6); average interest, maturities and grace period for each country; discounted at mortgage rate or government bond rate plus 1 per cent. Data source, see annex text.

[e] Pincus, *op. cit.* pp. 135, 140. Nominal aid based on commitments; formulae *(d)* and *(e)* used for discounting most loans, actual repayment schedule for others, loans discounted loan by loan with actual grace periods, maturities and interest rates; discounted at mortgage rate or government bond rate, plus 1 per cent. Data supplied by OECD.

None of these methods can be termed right or wrong, although the closer the analysis approaches a loan by loan discounting based on actual loan terms, actual repayment schedules and actual domestic opportunity costs, the closer it meets the tests of relevance to current cost of aid. OECD and Pincus have sought consistency by relating commitments to loan terms and conditions which, for the years in question, are generally available only on a commitments basis. Ohlin and Little and Clifford have sought relevance by relating their computations to the flow of resources. Each pays a price in accuracy, the former because of the divergence between commitments and actual aid flows; the latter because of the notional quality of their estimates of terms and conditions, as well as the inaccuracies introduced by use of a uniform discount rate.

The OECD study includes an estimate [f] of the "grant-element" of multilateral aid in 1965 discounted at 10 per cent, showing grant equivalents of 32 per cent (IBRD), 84 per cent (IDA) and 44 per cent Inter-American Development Bank (IDB) for the three major lenders. The OECD study finds that on the average DAC bilateral aid has a larger grant element than multilateral aid because most multilateral aid is in the form of loans. However, the grant-element ratio of multilateral loans in 1965 was the same as that of bilateral loans, when both were discounted at the 10 per cent rate.

When we turn from computation to discussion, a number of common elements run through the various studies. They all agree that no single measure can encompass all the dimensions of resource transfer. The grant-equivalent approach as now formulated cannot encompass balance-of-payments problems, budget constraints, and the unquantified effects of private investment, or other effects described above as "genuinely qualitative". Nor does it take account of donor's benefits from aid. [g]

Some observers have questioned the validity of including reparations payments, [h] and have suggested that aid to former colonies falls in somewhat the same category as reparations. [i] A number of writers, such as Kaplan, have questioned the validity of comparing aid flows to GNP, particularly for international burden-sharing comparisons. These criticisms are not applied to grant-equivalent estimates, *per se*, but to the present methods of calculating aid and of making burden-sharing calculations.

While it is generally agreed that grant equivalents cannot measure all aspects of aid flows, the literature shows some confusion as to the extent of its applicability. Thus, the OECD report describes as a "major conceptual difficulty" such questions as whether the appropriate discount rate is the lender's or the borrower's, or whether the discount rate should be uniform for all countries. [j] As this report shows, these are not

[f] See OECD, *The Flow of Financial Resources to Less-Developed Countries, 1961-1965, op. cit.*, pp. 145-146.

[g] See Ohlin, *op. cit.*, p. 74; United Nations, Department of Economic and Social Affairs, *op. cit.*, pp. 44-45 and 126-127.

[h] See J. Pincus, *op. cit.*, p. 115, and J. Kaplan, *op. cit.*, p. 330.

[i] See J. Kaplan, *op. cit.*, p. 330.

[j] See OECD, *The Flow of Financial Resources to Less-Developed Countries, 1961-1965, op. cit.*, pp. 192-195.

conceptual difficulties but depend on the purposes of the particular enquiry.

The United Nations experts' report expresses reservations on grant-equivalent calculations, because of the difficulty of selecting discount rates that measure the marginal efficiency of investment. This reservation is particularly well taken for recipient countries in view of their disorganized capital markets and the presumed importance of external effects in determining the social marginal efficiency of capital. For developed countries, the problem is more manageable because of the superior organization of capital markets. Estimates of the social rate of return to capital in the United States in recent years have been close to the mortgage rate.[k] Evidently, much more work would be required in order to provide refined estimates. The reservations of the United Nations group, in this regard, should be taken to apply primarily to the present state of knowledge rather than to the method itself. As an interim device, the long-term bond rate offers an adequate discounting criterion. The United Nations group has correctly pointed out that there is typically a spread of bond rates, but this difficulty is easily disposed of by such devices as weighted averaging of rates.

Little and Clifford have pointed out[l] that the method fails to provide a single definition of aid volume on the donors' side, citing specifically discount rate problems and tying. Both of these elements, however, are amenable to analysis as indicated above. Little and Clifford are on far stronger ground in pointing out the deficiencies of grant-equivalent analysis for measuring recipient's benefit. The full effects of tying are particularly difficult to estimate.

In summary, there has been general recognition that grant equivalents cannot subsume all aspects of aid in a single measure for each donor and a single measure for each recipient. But there has also been some confusion between conceptual problems, on the one hand, which can be solved, if at all, only at a rather high level of abstraction; and data problems, on the other hand, which require primarily further analysis and refinement of the data but have no inherent barriers. Naturally, perfectly precise measurement, even of those elements that are in principle measurable, will continue to elude us. But one aim of science is to improve the accuracy of measurement, even if ultimate precision seems remote.

[k] See Otto Eckstein, "A Survey of The Theory of Public Expenditures," in National Bureau of Economic Research, *Public Finances: Needs, Sources and Utilization* (Princeton University Press, 1961), pp. 439-504.

[l] *Op. cit.*, p. 72.

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The Horowitz proposal
Study by the UNCTAD secretariat

[Original text: English]
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Chapter I

Introduction

1. The Committee on Invisibles and Financing related to Trade at its second session requested the Secretary-General of UNCTAD " to review the significance, if any, for the Horowitz proposal[1] of the general prospects of capital markets in the longer-term future, seeking such expert assistance as he might consider appropriate ".[2] In response to this request the present study has been prepared by the UNCTAD secretariat in consultation with financial experts.

2. The proposal rests on the generally accepted premise that the flow of aid to developing countries needs to be greatly increased and that the terms of assistance have to be softened considerably so as to permit an adequate net transfer of resources to developing countries and also to prevent explosive debt situations from emerging. It further assumes that because of budgetary constraints, there are limits to the growth of official aid flows but that the requisite resources for aid can be found in the capital markets of developed countries. Since funds on the capital markets can only be raised on commercial terms, there is need for subsidies to make these funds available on soft terms to developing countries. Thus the proposal envisages an international institution raising funds on national capital markets of developed countries on normal commercial terms and relending these funds through the International Development Association (IDA) to developing countries at low rates of interest for a suggested period of thirty years.[3] The difference between the cost of borrowing to the institution and the lower rates of interest on lending would be covered by an interest equalization fund. The resources for this fund would be obtained through budgetary allocations of the developed countries to IDA, through the allocation of some portion of the net income of IBRD, or through some combination of both methods.

3. The IBRD staff study of the Horowitz proposal, prepared in accordance with recommendation A.IV.11 of the Conference, was presented in February 1965.[4] The IBRD staff examined the technical implications of the proposal and underlined certain problems likely to arise in its implementation. In particular it noted the limited borrowing prospects in the capital markets of North America and Europe, high borrowing rates then prevailing in the markets, possible competition between IDA and IBRD for the available funds, the problems involved in the establishment of IDA as a new borrower on the capital markets, the problems raised by government guarantees to IDA borrowing and the long-term aid commitments required by the creation of an interest equalization fund. In addition to the above technical issues, the report by the IBRD staff summarized the policy issues raised for the consideration of governments by the Horowitz proposal as follows: given the premise that IDA's resources should be substantially increased, would the governments concerned find it easier to achieve this objective *(a)* by employing the technique of the Horowitz proposal, thereby assuming the obligations as regards guarantees, the interest equalization fund, access to markets and refinancing; *(b)* by raising the level of their annual subscriptions to IDA; *(c)* by lending to IDA on IDA-type terms, whether out of borrowed or appropriated funds; or *(d)* by some combination of these approaches? At the same time, the IBRD staff study noted that " there can be little doubt that if governments of the industrialized countries were to *(a)* give borrowings for IDA the necessary priority over other borrowers in access to their markets, *(b)* provide guarantees satisfactory to the market, *(c)* permit the borrowings to be made at rates of interest attractive in relation to competing bond issues and *(d)* accept a long-term commitment to contribute to the interest equalization fund, the amount envisaged could be raised ".[5]

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[1] The Horowitz proposal for financing economic development was first submitted to the United Nations Conference on Trade and Development at its first session in 1964 by Israel (see Conference document E/CONF.46/C.3/2 and E/CONF.46/C.3/L.5/Rev.1). The Conference expressed strong interest in the proposal and recommended that a further study be made by the International Bank for Reconstruction and Development (IBRD). (See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 48, annex A.IV.11.)

[2] See *Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3* (TD/B/118/Rev.1), para. 89.

[3] The international institution concerned could be IBRD or IDA itself. The funds raised would be additional to those required by IBRD for its normal transactions and the resulting obligations would be backed by new and independent guarantees.

[4] IBRD, *The Horowitz Proposal: A Staff Report* (Washington, D.C. 1965).

[5] *Ibid.*

4. At its first session held at Geneva in December 1965, the Committee on Invisibles and Financing related to Trade recommended the appointment of an expert group to review the Horowitz proposal, similar schemes and possible variations, giving due regard to the IBRD staff study.

5. The Group of Experts met in April 1966 and it had before it both the original Horowitz proposal and an amended version submitted by Mr. Horowitz.[6]

6. The original proposal envisaged a new and independent system of government guarantees, applicable to principal and interest, in which all of the industrialized countries which are members of IDA (i.e., the Part I countries) would participate. The guarantees would apply directly to market borrowings of IDA or, if IBRD should be the borrowing agency, would alternatively apply to loans made by IBRD to IDA out of the proceeds of the market borrowings. The provision of new guarantees would facilitate operations in the market by assuring bond holders that the fact that the borrowed money was to be re-lent by IDA to developing countries on soft terms did not imply any risks as to the repayment of interest and principal to bond holders. New and separate guarantees would also prevent adverse effects on the credit standing of IBRD should it be chosen as the borrowing agency for implementation of the Horowitz proposal. The UNCTAD Group of Experts agreed that loans by the World Bank to IDA "made subject to several guarantees as to the capital and interest could not possibly be regarded as adversely affecting the Bank's credit standing".[7]

7. Since obtaining a system of additional government guarantees might prove to be difficult, the Group of Experts considered an amended version of the proposal which differed from the earlier version in so far as it did not provide for a separate system of guarantees. According to this amended version, IBRD would borrow increased amounts on capital markets on the strength of its existing system of guarantees and re-lend them to IDA. In other words, holders of existing IBRD bonds would have to share with the new bond holders the protection afforded by the existing guarantees to back the obligations of IBRD. The amended Horowitz proposal thus gave rise to the following major question: How would the credit-worthiness of IBRD be affected in the eyes of existing and potential holders of IBRD bonds if IBRD were to borrow increased amounts on capital markets and, without separate and additional guarantees, were to make these funds available to IDA for relending on soft terms? The members of the Group of Experts were unable to agree on the question whether or not this absence of separate guarantees would impair the credit standing of IBRD.[8] In any case, the representative of IBRD at the meeting of the expert group made it clear that IBRD would not be prepared to make any loans to IDA that were not secured by additional guarantees.

8. While the Group of Experts regarded the existing climate in both the North American and European markets as "generally unfavourable", it pointed out that "the absorptive capacity of these markets is capable of expansion and has, in fact, grown more rapidly than might have been expected in recent years". The Group went on to add that "it is necessary to take into account not merely the short-term position but also the possibility that in the longer run the situation in capital markets may improve significantly".[9]

9. Since both the Bank staff and the Group of Experts prepared their respective reports at a time when capital markets were extremely tight, it is natural that these unfavourable conditions should have had an influence on the approach adopted by them. However, as the Group of Experts itself recognized, it is important not to be unduly influenced by the temporary ups and downs of capital markets and the long-term outlook should be kept in view. It is for this reason that the Committee on Invisibles and Financing related to Trade at its second session requested the Secretary-General of UNCTAD "to review the significance, if any, for the Horowitz proposal of the general prospects of capital markets in the longer-term future".

10. The present report has been discussed with Mr. Sixto Roxas, who had served as Chairman of the Group of Experts on the Horowitz proposal, and with Professor Richard Cooper of Yale University, and takes their views into account. Mr. Roxas and Professor Cooper are not, however, in any way responsible for the report.

11. The Horowitz proposal consists of three essential elements: *(a)* the use of capital markets as a source of funds for development lending by an international agency; *(b)* a system of guarantees to back up the indebtedness of that agency; and *(c)* a system of interest subsidies. The issues raised by these three elements are surveyed in the following pages.

Chapter II

Recent developments in capital markets

12. In contemplating the use of capital markets as a source of funds for development loans by an international agency, the Horowitz proposal does not constitute a radical departure from existing practice. IBRD borrows in various capital markets and also sells to private investors portions of the Bank's loans. The

[6] See "The Horowitz Proposal: report of the Group of Experts" (Trade and Development Board document TD/B/C.3/23), annex A.

[7] See "The Horowitz Proposal: report of the Group of Experts," *op. cit.*, para. 13.

[8] Some members of the Group of Experts considered that even without a separate system of guarantees, IBRD could lend (out of increased borrowings) to IDA an average of approximately $200 million annually for a five-year period on an experimental basis without impairment of its credit standing. Some members felt that the outstanding amount of such loans permitted should be restricted to no more than $100 million or possibly $200 million. Some other members felt that any deviation from present lending principles of IBRD might have disproportionate effects on the credit standing of IBRD (*Ibid.*, para. 15).

[9] *Ibid.*, paras. 6 and 7.

Inter-American Development Bank (IDB) also raises part of its funds in capital markets. The real question therefore does not relate to the principle of using capital markets but rather concerns the extent to which these markets can be made to yield additional funds for purpose of development finance, on soft terms.

National markets

13. Since 1960, there has been an over-all rise in net issues in the domestic capital markets of the developed countries. It can be seen from table 1 that, during the period 1960-1966, there has been a substantial increase

TABLE 1

National capital markets: Domestic net issues

($US million)

Country	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*
Belgium							
Public	441 [a]	245 [a]	591 [a]	201	417	594	537
Private bonds	171	245	258 [b]	220 [b]	114 [b]	307	309
Denmark							
Public	...	...	−26	−27	−26	−20	−23
Private bonds	...	...	381	496	504	699	607
Federal Republic of Germany							
Public	283 [c]	218 [c]	618 [c]	901 [c]	822 [d]	776 [d]	106 [d]
Private bonds	758	1,484	1,766	2,133	2,575	2,336	1,306
France							
Public	4 [e]	49 [e]	−159	457	208	139	170
Private bonds	924 [e]	1,086 [e]	865	1,004	1,049	1,293	1,547
Italy							
Public [f]	300	263	100	−114	367	1,060	2,484
Private bonds	1,017	933	1,586	1,838	1,954	2,073	1,917
Netherlands							
Public	337 [g]	125 [g]	31 [g]	281 [g]	136	155	177
Private bonds	37	14	83	−6	39	197	221
Spain							
Public	...	...	90	227	389	610	557
Private bonds	...	...	185	345	332	432	437
Sweden							
Public	141	−14	106	429	93	−17	2
Private bonds	195	291	594	375	612	542	932
Switzerland [h]							
Public	−39	−37	−12	−16	116	123	208
Private bonds	214	273	457	508	491	419	367
United Kingdom							
Public [i]	392	−477	1,989	−84	−558	1,205	1,172
Private bonds	252	393	476	671	809	1,037	1,395
United States [j]							
Public [k]	4,600	1,400	6,500	8,500	5,900	1,400	4,300
Private bonds	5,000	5,100	5,000	5,300	6,600	8,100	11,300
Canada							
Public	1,435 [l]	2,157 [l]	1,577 [l]	2,109 [l]	1,341	567	1,605
Private bonds	321	336	390	518	521	856	471
Japan							
Public	...	...	701	1,025	145	391	2,797
Private bonds	...	...	1,122	1,483	2,523 [m]	3,854 [m]	4,345 [m]
TOTAL							
Public	7,894	3,929	11,706	13,889	9,350	6,983	14,092
Private bonds [n]	8,889	10,155	13,163	14,885	18,123	22,145	25,154

Source: UNCTAD secretariat based on BIS *Thirty-third Annual Report, Thirty-fourth Annual Report; Thirty-seventh Annual Report.*

[a] Includes change in medium and long-term direct debt. The 1962 figure excludes the December conversion into non-negotiable bonds of part of the banks' compulsory holdings of certain treasury certificates issued in 1957.

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

[c] Includes change in market holdings of bonded loans and premium treasury bonds. Excludes Development Aid Loan in 1961, the special subscriptions to which brought in DM 1,180 million.

[d] Includes change in market holdings of bonded loans and medium-term notes.

[e] Gross issues.

[f] Includes indirect treasury borrowing.

[g] Excludes payments into pre-subscription accounts.

[h] Includes privately-placed issues.

[i] Includes change in marketable debt (excluding treasury bills) in public hands.

[j] Figures for the years 1962-1966 are based on Federal Reserve flow-of-funds data, excluding mortgage loans.

[k] Includes change in public holdings of marketable debt having a maturity of one year or more.

[l] Includes amounts held outside government accounts.

[m] Includes public corporation bonds.

[n] Includes issues of semi-public credit institutions and nationalized industries.

in the volume of net issues by both the public and private sectors of these countries. Public and " private " borrowing on a net basis rose from approximately $16,700 million in 1960 to $39,200 million in 1966.[10] Governments of most developed countries with market economies are increasingly relying on bond issues and it is estimated that in most of these countries the public sector accounts for at least 40 per cent of new bond issues at the present time.[11]

14. The factors responsible for changes in net issues are many and vary from year to year and from country to country.[12] For instance, the relatively small amount of corporate bond issues in the early 1960s in the United States market can, broadly speaking, be attributed to the availability of corporate internal funds relative to investment requirements.[13] On the other hand, the large rise in corporate net issues which occurred in the United States market between 1965 and 1966 may be attributed to the sharp increase in capital spending, much of which was financed through bank borrowing and bond issues. In 1966 and 1967 the narrowing of profit margins, the acceleration in corporate tax payments, anticipatory hedging against possible higher interest rates and the financing needs of the Government were some of the main factors which helped to account for the large amount of corporate bond financing.[14]

15. The figures given in table 1 must thus be interpreted with care. However, despite the many qualifications which are necessary in analysing each market, there appears to be little doubt that the period 1960-1966 has been marked by an over-all increase in net issues by both the public and private sectors.

16. Net foreign issues on national markets rose from approximately $800 million in 1960 to $1,900 million in the year 1966 (table 2).[15] The United States accounted for the vast majority of these issues during the period 1960-1966 as approximately three-quarters of all foreign issues on domestic markets were placed in the United States market.

TABLE 2

Foreign and international bond issues, 1960-1967 [a]

($US million)

Years	*International issues*	*Foreign issues on national markets*
1960	...	800 [b]
1961	...	1,100 [b]
1962	...	1,400 [b]
1963	100	1,800
1964	800	1,500
1965	1,200	1,800
1966	1,200	1,900
1967	1,800 [c]	...

Sources: UNCTAD secretariat, based on BIS, *Thirty-seventh Annual Report*, and United States Congress, Joint Economic Committee, *op. cit.*

[a] Unless noted otherwise, the figures given above include all the countries in table 1 and international institutions. The figures also include private placements. Company borrowing through foreign subsidiaries is normally treated as borrowing by the country of the parent company. Non-resident loans issued in the Federal Republic of Germany after the announcement of the 25 per cent coupon tax in March 1964 are generally treated as international issues. Since such issues are exempt from the tax, they were issued at interest rates below those prevailing on the domestic market for sale mainly to foreigners.

[b] Figures include Federal Republic of Germany, Netherlands, Sweden, Switzerland, United Kingdom and United States. Refunding issues are included but IBRD issues are excluded. European data are nominal amounts; United States data are net of discounts and commissions. European data cover only publicly offered issues; United States data cover both public offerings and private placements, including issues purchased in connexion with United States direct investments abroad. European and United States data include purchases by both residents and non-residents. The United States data shown thus differ from United States balance-of-payments figures on new issues of foreign securities, which cover only portfolio purchases by United States residents and include equities as well as bonds.

[c] Estimated figure.

17. The rise in foreign issues on national markets would probably have been much larger had it not been for government policies in the major developed countries. In recent years, a number of major countries, including Switzerland and the United States, introduced formal and/or informal restrictions which are, in large part, attributable to balance of payments disequilibria or to fears that domestic policies would be disrupted or that domestic capital requirements would go unsatisfied.

The international or " Euro-issue " market

18. An important extension of the international capital market has taken place during the past few years in response to a tightening of controls on traditional foreign issues. In 1963 and 1964, particularly, restrictions were introduced on foreign issues in both the United States and Swiss markets. Potential borrowers in these markets could not turn to markets in other countries since these were already subject to tight restrictions.

[10] The figures used throughout this paper are intended to show broad over-all changes which have occurred in capital markets. It would be necessary to introduce numerous modifications in order to place the figures for each country on a strictly comparable basis. For the most part, net figures are used throughout in order to show the new money raised by the issue of securities. While gross figures would have helped to indicate the capacity to absorb new issues, such figures were available on a comparable basis only for the years 1960-1962. See United States Congress, Joint Economic Committee, *Economic Policies and Practices, Paper No. 3, A Description and Analysis of Certain European Capital Markets* (Washington, D.C., U.S. Government Printing Office, 1964). The figures for private borrowing given in table 1 are overestimates in so far as they include issues of semi-public credit institutions and nationalized industries.

[11] OECD, " Improving the Working of Capital Markets," *OECD Observer*, No. 27, Paris, April 1967.

[12] For a discussion of the individual characteristics of each market and the factors which influence these markets see S. Rolfe, " Capital Markets in Atlantic Economic Relationships," the Atlantic Institute ; EEC Commission, *The Development of a European Capital Market : report of a group of experts appointed by the EEC Commission* (Brussels, 1966) ; United States Congress, Joint Economic Committee, *op. cit.* See also *Annual Reports* of the Bank for International Settlements (BIS).

[13] See Salomon Brothers and Hutzler, *1965 Annual Review of the Bond Market*, p. 12.

[14] In recent years, part of the increase in corporate bond financing in the United States has been due to an increase in convertible debentures, i.e., bonds which can be converted into equities at some predetermined price. These issues reduce the cost of corporate borrowing as bond-holders are willing to accept a lower rate of interest in exchange for expected capital gains arising out of the appreciation of equity prices.

[15] The rise is overstated in so far as the 1966 estimate includes a figure for gross issues in the United States market.

Meanwhile there was a substantial and growing volume of funds available for investment in long-term issues of high quality. The result was the growth of the so-called international bond market. In this market, bonds are denominated in United States dollars or some other acceptable currency and are issued on behalf of third country lenders and borrowers—the new international capital market, in short, is foreign to both borrower and lender and thereby escapes the usual sort of control on the issuance of new foreign securities.[16] These issues are organized by the sponsoring syndicates for sale in more than one country and have the advantage that they require no special consent in the main issuing centres. Since the introduction of the United States interest equalization tax in 1963, new issues in the Euro-issue market have risen from less than $200 million in 1963 to $1,200 million in 1966 (see table 2). Preliminary estimates for the first half of 1967 indicate that a further significant increase is likely to occur in the year 1967 as new issues will approach $2,000 million.[17]

19. It has been pointed out, however, that the growth of the international market has been confined almost entirely to borrowings by governments and corporate elite.[18] Estimates for the first half of 1967 indicate that over 80 per cent of new issues have been denominated in United States dollars.[19] This is slightly above the average for the period 1960-1966. In which roughly 70 per cent were denominated in dollars. While exact information regarding the source of funds is not available, it would appear that substantial amounts originate in developing countries.[20] The Euro-issue market has, for this reason, been described as "a type of reverse-development plan".[21]

20. While there has been an expansion in each of the markets described above, developing countries, for the most part, have not shared in this growth. During the period 1960-1965, the gross value of bond issues of developing countries as a whole has remained roughly constant, rising from $170 million in 1960 to $210 million in 1965.[22] In 1966 total issues were approximately $223 million.[23] More than 70 per cent of developing countries' issues for the period 1960-1966 can be attributed to two countries, Mexico and Israel. In both these cases, special factors seem to have been at work and it seems doubtful if other developing countries would be able presently to raise by themselves significant amounts on the capital markets of developed countries. Preliminary estimates for the first half of 1967 show total issues of $89.1 million, $89 million of which were placed by Israel and Mexico.

21. The foregoing account makes it clear that during the 1960s there has been a significant growth in the capital markets of developed countries. It is of course true that many of these markets have been faced in recent years with tight conditions. But this is because the demand for long-term funds has increased even faster than the supply. However, the tightness of markets has not always been due to the shortage of savings. As a recent EEC report has pointed out, "the present shortcomings of the capital markets are due not so much to insufficient savings as the impossibility of adjusting correctly supply and demand on markets that are too narrow".[24] Sustained economic growth resulting in higher savings and a reform of the capital markets in Europe should add further to the future capabilities of these markets.

22. It has been argued that while the capacities of world capital markets have increased substantially, the relevant comparison for the Horowitz proposal should be the amount of foreign issues on national markets. Even if this view were accepted, the preceding description shows that net foreign issues have risen since 1960, i.e. from under $1,000 million in 1960 to $1,900 million in 1966. A more serious point is that institutions like IBRD are currently faced with the prospect of being unable to raise all the needed funds in the next few years in the capital markets[25] because of the difficulty of obtaining access to capital markets of the developed countries. So long as such restrictions are maintained, the prospects for additional borrowing that would not interfere with existing flotations by multilateral institutions are bound to be poor. However, it is to be hoped that developed countries even under existing conditions might allocate a proportion of the increase in the capacity of their capital markets to flotations by multilateral institutions; it is presumably not the intention to maintain these restrictions at their present level indefinitely. Since it would in any case take a considerable time to prepare the groundwork for a scheme of the Horowitz type as well as to obtain the necessary guarantees, the present state of the capital market should not prevent further examination of such schemes.

23. It has been suggested that if the raising of resources under the Horowitz proposal is concentrated on the markets of surplus countries, this may give rise to an inequitable distribution of the burden of providing resources. However, this is not inevitable over a longer period of time particularly if countries' balance-of-payments positions change over time so that surplus country (as opposed to the balance-of-payments burden) should be borne in mind that the resource burden on a country (as opposed to the balance-of-payments burden) is not measured by the amount of resources raised on

[16] David Williams, "Foreign Currency Issues on European Security Markets," *IMF Staff Papers*, vol. XIV, No. 1, March 1967, p. 44.

[17] H. Erich Heinemann, "Eurobond Market is Expanding," *The New York Times*, 13 September 1967. See also Neil McInnes, "Global Pinch," *Barrons National Business and Financial Weekly*, New York, 17 July 1967, for a discussion of recent trends.

[18] Nathaniel Samuels, "The Shaping of the Future International Money and Capital Markets," National Industrial Conference Board Panel, 22 November 1966.

[19] Heinemann, *op. cit.*

[20] Rolfe, *op. cit.*, Williams, *op. cit.*

[21] Rolfe, *op. cit.*

[22] *Official Records of the Economic and Social Council, Forty-third Session, Annexes*, agenda item 5, document E/4375.

[23] IBRD-IDA, *Annual Report 1966/1967*.

[24] See EEC Commission, *op. cit.*, p. 15.

[25] See statement by the representative of the International Bank for Reconstruction and Development at the 13th meeting of the Sessional Committee on IBRD transfers to the International Development Association (Trade and Development Board document TD/B/SC.7/L.4).

its capital market since the money is to be raised on normal commercial terms. The real resource burden on a country is represented by its contribution to the interest equalization fund. It should be possible to distribute this burden in an equitable manner among various countries on the basis of objective criteria.

24. Even under present conditions, substantial amounts could be raised in the international market. Financial experts consulted in the preparation of this paper have estimated that an amount of up to $200 million per annum could be raised in the international market if the borrowing agency were an accredited institution backed by joint and several government guarantees.

Chapter III

Guarantees

25. It has to be recognized that without proper guarantees it would be difficult for an international agency like IDA to raise significant amounts of financial resources on capital markets for lending to developing countries. In the case of the obligations of IBRD, member countries provide guarantees to the extent of their respective uncalled capital subscription. Guarantees can take various forms.[26] Under a system of " full joint and several guarantees ", each guarantor would be liable for the full amount of the guaranteed obligations and a bondholder could make a claim against any single guarantor for the full amount. On the other hand, under a " several guarantee " system each guarantor would guarantee only a specified proportion of each bond. An intermediate possibility is represented by a system under which a guarantor, while giving only a several guarantee, would contribute, in an amount based on the proportion of the bonds guaranteed by it, to a fund to be shared by the bondholders in the event of a default. This is described as a " limited joint and several guarantee " and resembles the existing system of guarantees provided by member governments for the obligations of IBRD.

26. The UNCTAD Group of Experts on the Horowitz proposal considered that difficulties would be involved in getting joint and several guarantees to back up the obligations of IDA and that governments might be more willing to provide several guarantees than limited joint and several guarantees. The Group of Experts therefore suggested that IBRD (assuming it to be the borrowing agency on behalf of IDA) might consider " several guarantees of the IDA Part I members in appropriate proportions ".[27] As noted earlier, the Group believed that loans made subject to a separate system of several guarantees as to the capital and interest " could not possibly be regarded as adversely affecting the Bank's credit standing ".[28] The ease with which a separate system of several guarantees could be obtained depends almost entirely on the political will of the governments concerned.

[26] See *The Horowitz Proposal: A Staff Report, op. cit.*

[27] See " The Horowitz proposal: report of the Group of Experts," *op. cit.*, p. 13.

[28] *Ibid.*

Chapter IV

Interest subsidies: existing practices

27. The suggestion in the Horowitz proposal that interest subsidies be used to raise amounts which would otherwise not be available and to lower the effective rate of interest is by no means an untried technique. Interest subsidies have been granted in numerous instances by individual governments in the major developed countries in order to help certain domestic sectors. Nor has the use of interest subsidies been restricted solely to the domestic sphere. Some developed countries are already subsidizing, through budgetary appropriations, the interest rates on funds allocated for external assistance which they borrow on their capital markets. For example, in 1964 the Netherlands, in expanding long-term lending to countries outside the Kingdom, employed budgetary interest rate subsidies to hold long-term rates at the IBRD interest rate level.[29] In 1965 the Netherlands decided to adopt further measures which would bring interest rates down to 3 per cent.[30] In one sense, nearly all development lending can be said to contain some element of interest subsidy since most development lending, and even some portion of export financing, take place at interest rates below the normal commercial rates.

28. In the sphere of multilateral aid, it seems relevant to mention the interest rebate system of the European Investment Bank (EIB). The beneficiaries of interest subsidies are Greece and Turkey and also the Associated Countries and Territories. In 1964, interest rebates financed by special budgetary provisions in the countries of EEC helped to lower the effective interest rates on loans by EIB to Greece and Turkey.[31] At the request of the Associated African States and Madagascar and the Associated Overseas Countries and Territories, ordinary loans of EIB to those areas may be accompanied by interest rebates (at rates of up to 3 per cent) financed from the grant contributions to the European Development Fund (EDF).[32]

29. The Horowitz proposal envisages the establishment of an interest equalization reserve as a means of lowering the effective long-term rate of interest on borrowings of the developing countries.

30. The creation of an interest equalization fund, as the IBRD staff study pointed out, raises no particularly difficult technical problem. However, the proposal does involve an express or implied commitment on the part of governments to appropriate funds for the interest equalization fund for a long period of time. It has been suggested that the long-term nature of the commitment may raise problems since budgetary appropriations in

[29] See OECD, *Development Assistance Efforts and Policies, 1965 Review* (Paris, 1965), p. 85.

[30] See OECD, *Development Assistance Efforts and Policies, 1966 Review* (Paris, 1966), p. 107.

[31] OECD, *1965 Review, op. cit.*, p. 87.

[32] EIB, *Details of the intervention of the European Investment Bank in the countries associated with the European Economic Community*. In addition, special term loans which are normally on concessional terms are granted under certain conditions.

most countries currently take place on an annual basis. However, the problems involved are not insoluble. Development assistance channelled through IDA has involved a commitment to make future payments of a specified amount: five years in the case of initial subscriptions, three for the first replenishment. It has also been suggested that should the long-term nature of commitments prove to be a problem, the difficulty could be overcome if a country's estimated aggregate obligations to the interest equalization fund over some period ahead were to be appropriated within a brief span of years, rather than in smaller amounts annually. The amounts appropriated could be segregated in a special account, either in the custody of the country itself or of IDA, to be drawn upon annually to discharge the country's obligation to the interest equalization fund. Funds retained in the special account could be invested and the income credited to the interest equalization fund to reduce the aggregate amounts required.

Chapter V

Conclusion

31. Recent developments in capital markets, notably the imposition of restrictions on IBRD borrowing, make it clear that the short-term outlook for schemes of the Horowitz type has not improved since the report of the Group of Experts, as far as borrowing possibilities on national markets are concerned. On the other hand, there is growing unexploited potential in the international bond market which may not be subject to restrictions to the same extent as domestic markets.

32. If restrictions on national capital markets are eased or eliminated in the longer run, it would appear that there should be ample scope for schemes of the type discussed in this report. Both the interest equalization fund and the institution of an appropriate system of guarantees present no serious technical problems. It is now generally recognized that there is a need to improve the functioning of capital markets in order to facilitate and to increase the transfer of savings into long-term investment.[33] If such improvements take place, and if the vast institutional savings which flow into capital markets continue their annual rates of increase, it would be reasonable to assume that significant amounts of resouces could be raised for re-lending to developing countries at low rates of interest.

[33] See Rolfe, *op. cit.*, p. 15.

DOCUMENT TD/7/SUPP.16

Suppliers' credits — rediscounting facilities for exports from developing countries

Report by the IBRD staff *

[Original text: English]
[15 February 1968]

1. This report has been prepared by the IBRD staff to inform the second session of the United Nations Conference on Trade and Development of the work it has carried out in response to recommendation A.IV.14 of the first session.[1] In compliance with that recommendation, the Bank staff prepared a study on "Suppliers' Credits from Industrialized to Developing Countries", which was transmitted to the Secretary General of the United Nations by the President of the Bank on 20 January 1967.[2] Complementary studies were made by the United Nations Secretariat on the same subject.[3]

2. The Bank staff study on suppliers' credits from industrialized to developing countries contained recommendations on the collection of information, administration of external debt, co-ordination of creditor practices and policies, and international co-ordination for individual countries. These recommendations have been discussed in various international forums since the transmittal of the study to the United Nations and its general release. In some of the fields covered by the recommendations, the Bank itself has always been involved in the course of its operations. Since the publication of the study steps have been taken to implement the expanded reporting system on external lending of the Organisation for Economic Co-operation and Development (OECD) and (IBRD). Reporting forms were mailed to participating countries in August 1967. Some replies have been received. A meeting will be held in March 1968 at OECD in Paris where the two institutions will present a progress report and problems encountered will be discussed with member countries. As regards administration of external debt and international co-ordination for individual countries, the Bank continues to follow the subjects closely and to consult with developing countries concerning external borrowing policies, as well as to present analyses bearing on appropriate terms of lending in deliberations of the international consortia and consultative groups over which it presides. In the context of its general promotion of better co-ordination among national and international development finance agencies, the Bank has continued its efforts to negotiate arrangements under which substantial amounts of export credits furnished or guaranteed by national export credit agencies can be associated with Bank-financed projects. In this connexion, the Governments of several major capital-exporting countries have taken the position that credits, or credit guarantees, involved in joint financing schemes to which IBRD is a party need not be subject to all the limiting conditions normally governing such credits or guarantees. The United Nations Secretariat is continuing its work on the subject of export credits from industrialized to developing countries by keeping up to date part two of its studies mentioned above, pursuant to resolution 1270 (XLIII) adopted by the United Nations Economic and Social Council in August 1967.[4]

3. The second aspect of suppliers' credits included in the resolution, namely their use to finance exports from developing countries, was not dealt with in the study completed by the Bank staff in January 1967, since it is quite different in nature from the first aspect and required separate consideration. A step towards such consideration has been undertaken by Bank staff through a review of the rediscounting facilities for export credits available at the Inter-American Development Bank (IDB), and through consultations with the African and Asian Development Banks as to the need for such facilities in their member countries and whether they are contemplating schemes similar to that of IDB. This report is based in part on the views expressed during those consultations. An account of the IDB scheme is annexed to this report.

4. To ensure co-ordination of future work on the second aspect of suppliers' credits, the Bank staff has consulted with the Fiscal and Financial Branch of the United Nations Department of Economic and Social Affairs. Following suggestions by some delegations in the course of the work of the UNCTAD Committee on Invisibles and Financing Related to Trade, and in response to a specific directive of the United Nations Economic and

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* This report does not purport to represent the views of the Executive Directors of the Bank, or of the Governments which appointed or elected them.

[1] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I: *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 50.

[2] A revised edition was issued on 3 April 1967.

[3] *Export Credits and Development Financing* (United Nations publication, Sales No.: 67.II.D.1).

[4] The resolution requested the Secretary-General of the United Nations

"(a) To keep up to date the country studies...

(b) To consult with the appropriate national and international authorities on the best means of establishing the most practical national and regional schemes for the financing of capital goods exports by and among the developing countries, on the basis of the available experience with existing export credit schemes in developing and developed countries."

Social Council (resolution 1270 (XLIII) of August 1967), the United Nations Secretariat is undertaking a programme of work which is described in detail in a progress report which it has prepared for the second session of the Conference.[5] As a first stage, a full field evaluation is being made of existing national export credit systems in developing countries, in order to determine the characteristics and conditions that make for effective systems; and an inquiry is being conducted in the other developing countries on their relevant trade patterns and potentials and on the availability and possibilities of export financing and insurance facilities. At the conclusion of the first stage, the United Nations Secretariat plans to review with IBRD and other interested agencies the material gathered, the possible lines along which proposals for expanding export credit financing and insurance facilities in developing countries could evolve, and the appropriate arrangements for co-operation at subsequent stages of the work.

5. In view of the work being carried out by the United Nations Secretariat, the Bank does not contemplate at this time undertaking any systematic study of the same subject. It will nervertheless continue to be concerned with the subject in the course of its regular consultations on economic policy matters with developing member countries.

6. The subject of export growth of developing countries, which is generally recognized as a basic factor in the solution of their long-run balance of payments difficulties, recently became one of the most intensively discussed topics in the field of development economics. This report does not intend to go into a detailed discussion of the problem, and only presents certain observations which may shed some light on the discussion of credit facilities for the exports of durable producers' goods from developing countries.

7. One of the characteristics of developing countries is that a large proportion of their export earnings is often derived from only a few commodities. Of the forty-eight countries in which three commodities made up 50 per cent or more of total exports in 1957, only four were developed countries. A recent IBRD staff survey of eighty-six developing countries showed that, in 1965, thirty-eight countries relied on a single product for more than one-half of their export earnings from commodity trade. Seventy-six countries relied on one to seven products for more than 50 per cent of their export earnings, while for the remaining ten, from one to seven products accounted for between 25 and 49 per cent of such earnings.

8. It is widely accepted that the diversification of production, and a consequent diversification of exports, are an essential feature of sound economic growth of developing countries. Although import substitution offers one avenue for bringing about economic growth and a diversification of domestic production and has been widely adopted to achieve industrial development, it is of limited usefulness and subject to abuse by becoming a device for excessive protection. In any case the growth of a manufacturing sector and the accompanying increase of the national product in general have led to a substantial rise in the import bill even where local industries were based on nationally available raw materials. This has resulted in a continuation of balance-of-payments problems in the countries concerned and has emphasized the need for securing a faster growth of exports. The apparent conflict between policies of export expansion and diversification and of import substitution is in part one of time perspective. Regardless of the balance-of-payments effects in the short run, in the long run an economically sound import substitution sector would promote growth through an increase in the export of manufactured goods.[6] A basic requirement is that these goods be competitive in the world market. Unfortunately, however, in the development of import substituting industries, insufficient attention has often been paid in the past to the costs involved and the international competitiveness of their products.[7]

9. The recent export experience of developing countries has shown a trend towards export diversification, particularly into manufactures. World export trade in manufactures has in recent years tended to expand about twice as fast as the export trade in primary products.[8] Between 1959/60 and 1965/66, the total exports of developing countries increased by 41 per cent, the growth of primary products (including non-ferrous metals) being 36 per cent and of manufactured products, 104 per cent.[9] Were we to consider the exports of only those countries which are responsible for the bulk of the exports of manufactured goods from developing countries, the contrast between the rates of growth of exports of primary products and of manufactured goods would, in all likelihood, be even sharper. Manufactured goods production in developing countries increased by 60 per cent over the period. There has been an acceleration of the growth rate of manufactured goods exports of the developing countries from 4.8 per cent annually in 1955-1960 to 9.7 per cent in 1960-1965.[10] This acceleration in the growth of exports of manufactures has occurred even though the growth of manufacturing production has remained relatively constant. However, the growth is on a relatively small base, and manufactured goods made up only 14 per cent of total exports from developing countries in 1965-1966.

10. It is difficult to generalize about the sectors and industries which promise the most rapid export development in developing countries. It would appear to be widely true that in many countries industrial development has started with the growth of light consumer

[5] See volume III of this series, document TD/7/Supp.13.

[6] This paper refers only to industrial goods. It is clear that the development of agriculture on an economically sound basis leads to both import substitution and export expansion.

[7] See Santiago Macario, "Protectionism and Industrialization in Latin America," *Economic Bulletin for Latin America*, vol. IX, No. 1 (United Nations publication, Sales No.: 64.II.G.8).

[8] GATT, *International Trade, 1966* (Sales No. GATT/1967-1), p. 2.

[9] *Ibid.*, p. 37.

[10] GATT, "Preferences and other policy measures to stimulate exports of the less developed countries," Trade Intelligence Paper, No. 7, July 1966, para. 5.

goods industries. The production of durable capital goods requires, as a minimum, a fairly large domestic market, and therefore capital goods industries on any significant scale have begun only in the later stages, when the manufacturing sector has already become a significant part of the national economy and national income has risen substantially. Therefore the growth of exports of capital goods is likely to come only from those developing countries which are already relatively further advanced in industrial development. A study of the export experience of twenty-nine developing countries between 1950 and 1963 reveals certain patterns.[11] Minor exports[12] (including most manufactures except textiles) expand faster than major exports. Countries with small market shares in major exports tend to fare better than those with large shares. Countries with faster growth of manufacturing production tend to have faster growth of total and of minor exports (including manufactures). Studies by GATT also show that, in a number of manufactures which in the studies are described as " simple ", the comparative advantage has shifted to developing countries. In the case of other manufactures, the cost advantage usually tends to lie with developed countries. However, studies of heavy electrical equipment and automotive industries carried out in the Bank appear to indicate that the problem of competitiveness is to some extent a problem of scale. If capacity and production in these industries were planned, not only with the relatively small domestic market in mind, but with a view to export, and if excessive emphasis were not placed in all cases on uneconomically high domestic content, costs comparable with world prices might be achievable even in equipment industries. In the case of these industries, the significance of exports is thus underlined.

11. Experience shows that the development and expansion of exports of durable capital goods from developing countries faces many obstacles. Trade in such goods requires breaking into established markets in which consumers have often shown a preference for established brands manufactured in developed countries and with reliable and proven distribution and repair services. Products from developing countries frequently suffer in comparison also from high prices, particularly because marginal cost pricing is practised at times in the world markets for producer goods. Quality considerations and technological advancement may also constitute obstacles to capital goods exports by developing countries. The credit terms which the producer can give to the buyers are, nevertheless, also a most important factor in encouraging sales. This is particularly so in the case of sales to developing countries, as is evidenced by the rapid expansion of suppliers' credits to those countries and credit competition among suppliers which has led, among other things, to a lengthening of the period of payment. Thus international competitiveness in price and quality is not enough by itself to encourage exports. It must be supported by a marketing organization and finance.[13] What appears to be required is a " package " of financial, technical and marketing arrangements.

12. Regional integration among developing countries has been supported, among other reasons, as enabling the developing countries " to exploit systematically and intensively the opportunities available for trade expansion and economic co-operation among themselves ".[14] However, preferential tariff treatment alone within a common market would probably not be a sufficient condition for the growth of intraregional trade in capital goods. Bilateral trade and payments agreements have in some countries been used as a device for tackling *inter alia* some of these problems and thus increasing trade in capital goods with particular countries. However, with few exceptions they are a relatively unimportant feature in trade among developing countries. Further, bilateral payments agreements do not adequately attack the problems that inhibit exports of capital goods and, being subject to cancellation, they are unlikely to lead to a stable export market. Because of the consideration discussed above (para. 11) and the inadequacy of other arrangements such as bilateral trade and payment agreements, some developing countries have followed the example of the developed countries in establishing national schemes for export financing. National systems of export financing have been established in a number of developing countries, e.g., Argentina, Brazil, Mexico and Yugoslavia, and in some cases have played an important role in promoting the export of capital goods. However, generally speaking, credit involves deferment of receipts, and export credit implies deferment of foreign exchange receipts from exports. Developing countries face a situation of chronic foreign exchange shortage and their basic purpose in expanding exports is to get more foreign exchange. Additional exports on credit would increase foreign exchange receipts only in the long run. A scheme, presumably international, for refinancing these export credits would enable the developing countries to realize immediately the foreign exchange from credit sales of producer goods. Of course, to the extent that funds used for refinancing subtract from the flow of other assistance, the net gains to the less developed countries would be reduced.

13. Exports of manufactures, including durable capital goods, from developing countries are expected to

[11] B. A. de Vries, " The export experience of developing countries " IBRD Occasional Paper No. 3, 1967.

[12] Major exports are defined in the study to include all commodities which accounted for more than 5 per cent of merchandise exports in 1950-1963 of at least one of the countries in the group. Minor exports constitute all the rest.

[13] Intensive studies of the export effort of individual less developed countries undertaken in the GATT have identified export marketing as one of the main obstacles to a more rapid export expansion. Especially in the field of manufactured products, the term " export marketing " covers market research; publicity, advertising and selling; export financing; transport arrangements and insurance. In each of these areas, technical and even financial assistance could be given and would be most useful. See GATT, " Preferences and other policy measures to stimulate exports of the less developed countries," Trade Intelligence Paper No. 7, July 1966, para. 99.

[14] UNCTAD, *Trade Expansion and Economic Co-operation among Developing Countries: Report of the Committee of Experts* (United Nations publication, Sales No.: 67.II.D.2), para. 78.

grow. If exports of manufactures from developing countries continue to grow at the rate achieved during 1960-1965, they should reach about $10 billion in 1975.[15] However, a GATT study concludes that a rate of growth of 15 per cent "could materialize before 1975" with "special measures".[16] On this assumption, the total exports of manufactures from developing countries would be about $17.5 billion in 1975. If the share of durable capital goods remained constant, the annual export of such goods from developing countries could be between $1.4 and $2.4 billion by 1975.[17] Since in developed countries roughly one-third of capital goods exports may be financed by medium-term (suppliers') credits, it would be reasonable to expect on the basis of these rough estimates a substantial need for the financing of exports of durable capital goods from developing countries.

14. The only regional development bank which has established a scheme in this field of export financing is the Inter-American Development Bank (IDB) (for details, see annex). IDB established a programme for financing intraregional exports of capital goods in September 1963. The object of the programme is to enable Latin American exporters to compete, from the financing standpoint, on equal terms with suppliers from other areas. The capital goods eligible for financing must originate in the member countries (excluding the United States). Export credit transactions of more than 180 days and, in general, up to five years are financed. Credits of more than five years can, however, be extended if deemed necessary. The programme operates through national agencies appointed by the member countries. The total value of exports financed under the programme, as of 30 September 1967, was $18.9 million. The exports financed under the programme have originated chiefly in Mexico (49 per cent), Brazil (24 per cent) and Argentina (24 per cent). The chief importers of goods financed under the programme have been Argentina (46 per cent), Chile (25 per cent) and Peru (9 per cent).

15. The fact that the other regional development banks have not introduced schemes of this type does not constitute, *per se*, conclusive evidence that similar arrangements are not needed outside Latin America. However, the tentative and preliminary conclusions reached after the consultations with the regional banks, including IDB, seem to support the views expressed in the preceding paragraphs, which can be summarized as follows: first, the production of durable capital goods on a significant scale is usually undertaken only at a fairly advanced stage of the development process; secondly, in the absence of deliberate government export promotion policies, export problems for these goods may arise, depending on cost competitiveness, only where a persistent excess capacity exists, in relation to domestic demand, or where, in the case of a cyclical slackening in domestic demand, it is deemed appropriate to maintain output at a near capacity level and thus to find foreign outlets for the excess supply; thirdly, a need for rediscounting arrangements is therefore unlikely to arise in areas encompassing countries which are at a less advanced stage of economic growth, and as long as this situation prevails; fourthly, it may not arise on a significant scale even in countries or areas at a more advanced development stage, if the availability of capital goods for exports is intermittent and at prices and of a quality which are out of line with those prevailing in world markets.

16. As developing countries succeed in establishing more diversified and complex economies, more and more of them will reach the stage where a need for such arrangements will conceivably arise if sound economic policies are followed. In a few cases this stage may already have been reached. The possibility for the export of capital goods and therefore the need for refinancing facilities, however, would not depend solely on the rate of growth but also on a number of factors affecting the competitiveness of the goods involved, including careful planning and management of the industries concerned with a view to exporting a part of the output abroad, and an exchange policy that does not impede the flow of exports in general. The setting up of rediscounting facilities to support exports of capital goods by developing countries is a matter that deserves close consideration in connexion with the evolution of these countries towards more advanced stages of economic development.

[15] Exports of domestically produced manufactures from developing countries were valued at $4.25 billion in 1965 (GATT, *International Trade, 1966*, Sales No.: GATT/1967-1, p. 55). The rate of growth of exports of manufactures from developing countries during 1960-1965 was 9.7 per cent per year (GATT, "Preferences and other policy measures to stimulate exports of the less developed countries," Trade Intelligence Paper No. 7, July 1966.

[16] GATT, *ibid.*, para. 55.

[17] In 1965, exports of electric appliances, apparatus, office machines and metal manufactures and other heavy industrial products" accounted for 13.6 per cent of the developing countries' total export of manufactures of $4.25 billion (GATT, *International Trade, 1966*, Sales No.: GATT/1967-1, table 20).

ANNEX

The experience of the Inter-American Development Bank (IDB) in financing intraregional export trade *

A. *The system*

1. Pursuant to an April 1963 resolution (AG-8/63), the Board of the Inter-American Development Bank (IDB) approved, on 30 September 1963, regulations governing a programme for financing intraregional exports of capital goods. The Bank allotted an initial sum of $30 million to finance the programme. The aim of the programme is to enable Latin American exporters to compete, from the financing standpoint, on equal terms with suppliers from other areas.

2. Admitted to the financing facilities of IDB are exports of capital goods usually financed with medium-term credits in international trade practice. Since no precise definition of capital goods can be given, IDB has adopted a provisional list of goods which is revised from time to time, as necessary. The capital goods eligible for financing must originate in the Latin American countries (including Trinidad and Tobago) which are members of the Bank. Goods produced in a given

* As of 30 September, 1967.

country from raw materials or parts originating from other Latin American member countries (including Trinidad and Tobago) are considered to originate from the producing country. Goods are also considered to originate in a country when they include components imported from outside Latin America, but from member countries of the International Monetary Fund (IMF), provided that the c.i.f. value of the imported component is less than 50 per cent of the f.o.b. value of the goods. Goods are admitted under the programme if the imported component from countries not members of IMF is not more than 10 per cent, provided that they meet the criterion mentioned above.

3. The programme finances export credit transactions at medium term, or for a period of more than 180 days and, in general, up to five years. In establishing the periods, the conditions and practices customarily applied in international financing to the respective goods are considered. Credits of more than five years can be extended, particularly, to meet extra-regional competition. On operations financed under the programme, the Bank charges the national agencies an interest rate equal to that applied to its other operations from ordinary capital resources (at present 6.5 per cent).

4. The programme operates through national agencies appointed by the member countries. These agencies are, normally, those in charge of granting export financing in the member countries. The national agencies are responsible for centralizing programme operations and supervising compliance with the provisions of the regulations at the national level, particularly with regard to the nature of the exported goods, their origin, transaction terms and so on. National agencies normally also assume the financing of that portion of a transaction not paid in cash by the importer or financed by IDB.

5. The regulations foresee three possibilities as to the form in which IDB may deal with national agencies. These are: first, concession of global loans to national agencies with a fixed amortization period and interest rate, to be re-lent to exporters at different individual terms; secondly, opening of lines of credit to refinance export credits financed by national agencies either through rediscounting the credit documents of the importer, guaranteed by the national agency, or through issuance by the national agency of promissory notes to the order of IDB and thirdly, any other operation that the Bank may determine. In practice, IDB has used only line of credit agreements to refinance export credits granted by national agencies through the issuance by the national agencies of credit documents to the order of IDB. The preference given to promissory notes of the national agencies over the rediscounting of the importers, paper, with the full responsibility of the national agency, is due to the fact that the amount and the interest rate of the latter are generally higher than that of the IDB credit. The amortization terms of the promissory notes issued by the national agencies approximate those of the credit documents of the importers.

6. The amount covered by the line of credit is agreed between IDB and the national agency, taking into account the possibilities of utilization existing in the exporting countries. The resources of each line of credit are increased by the repayments to IDB that national agencies make during the period of utilization of the line of credits. Also, they can be increased by the sale of the credit documents which the Bank may effect without its guarantee. This provision has not as yet been put into practice.

7. The line of credit contract does not establish the repayment period. This period is set in the promissory notes issued by the national agency to IDB and must correspond approximately to the period included in the documents of the importer discounted by the national agency, it being understood that the periods in the latter documents must not be longer than the maximum authorized by IDB.

8. The Bank refinances up to 70 per cent of the export value, whether f.o.b. or c.i.f. value of the exports, provided the resulting amount does not exceed the part of the export credit financed by the national agency. Of the part financed by the national agency, only the principal is refinanced by IDB, not interest, which must be deducted even in cases where the documents of the importer do not specify interest separately. The exporter must assume a financial responsibility (commercial credit risk) for at least 15 per cent of the value of the credit extended to the importer.

B. *Operations of the system*

9. The situation of the IDB programme as of 30 September 1967 is shown in table 1. Since the beginning of the programme, six normal lines of credit and one "special" line of credit (see below) have been opened. Table 2 gives the value of exports financed by the programme, its origin and destination. Tables 3 and 4 give, in summary form, the type of capital goods exported by two major participants and financed under the programme.

10. Because the volume of operations is as yet relatively small, a few large individual operations loom large. Thus in Mexico, 31.7 per cent of the exports under the programme came from one enterprise (Tubos de Acero). In Brazil, where exports under the programme are more diversified, an operation covering the export of automotive body-stamping equipment from one producer (Willis) to its own counterpart in Argentina unduly influences the picture. However, it does not appear justified to conclude that the benefits of the programme are flowing only to a few large firms and particularly to trade among subsidiaries of the same foreign corporation located in different Latin American countries. Although full documentation on the individual firms is not readily available, a larger number of small operations with Latin American firms appear to have been undertaken.

C. *Suggested changes in the programme*

11. The instructions of the programme have been revised once since its inception. A supplementary instruction, issued in late 1966, considerably simplifies the procedures of the programme. This simplification originated in a meeting of all the national agencies with the Bank. On that occasion, a number of suggestions were advanced by the national agencies as to the possible expansion of the programme.

12. Three suggestions have been made on changing the list of goods to expand the coverage of the programme beyond capital goods proper: first, additions to the list of specific capital goods (such as typewriters, sewing machines and fertilizers); secondly, inclusion of goods which are not capital goods *per se* but which could be considered as such by reason of their utilization; thirdly, inclusion of all types of durable goods, even consumer goods, which are sold at terms of more than 180 days on the international market.

13. A number of other suggestions have been made. One which was adopted was to finance large exports through special lines of credit instead of within the line of credit for general goods included in the list. This new operation was established for financing exports in process of negotiation and involving substantial amounts. The special line of credit has a two-part period of validity: an initial period, coinciding with that required by the exporter to negotiate the export, and a second period coinciding with that necessary for the delivery of the goods. This new facility permits the national agencies to commit themselves with the exporters, and gives IDB additional flexibility since it can terminate the line of credit if the exporter's negotiations are unsuccessful. One such line has been opened for Brazil to finance the export of ships to Mexico. Negotiations between the exporter and importer are still in progress.

14. Proposals have been advanced to permit IDB to participate in the prefinancing of exports of goods involving long periods of production and aiming at effecting disbursements during the period of production, rather than waiting until the goods have been delivered to the importer. The regulations have not yet been changed but, in the case of the special line of credit described above, this procedure was permitted. Another proposal aims at extending the programme to financing exports intended for countries other than Latin American countries. Given the fact that transactions with third countries represent a small share of the national agencies' business and that the IDB financing of intra-regional trade frees resources that the national agencies can use to finance inter-regional trade, this suggestion has not been accepted.

15. One of the requirements of the regulations of IDB is that the exporter bear 15 per cent of the risks. Since insurance agencies in the field have raised maximum coverage over 85 per cent, a lowering of the 15 per cent level of financial responsibility (commercial credit risk) of the exporter is under study. Other ideas suggested for study include the setting up of national systems or a regional system of insurance or reinsurance against export credits risks.

Conclusions

16. The programme is still at a stage where it appears premature to draw any firm conclusions or to emphasize any clear tendencies. The ultimate test of the programme is its success in promoting capital goods exports. From the available information, the achievements of the programme in promoting intra-regional exports of capital goods is difficult to assess. It is true that a relatively small proportion of the capital goods exports of the countries in the programme have been financed by IDB. For example, Brazil's total capital goods exports to the Latin American Free Trade Association (LAFTA) countries in the two years 1964 and 1965 were $34 million, or about 7.6 times the amount of Brazilian exports financed by the programme by 30 September 1967. However, it can be argued that the relevant comparison should be made not with total capital goods exports but with capital goods exported on medium-term credit for which no figures are available. There is little doubt that the programme covers a relatively large part of the total intraregional exports on medium-term credit. It cannot be said, without more information from the countries concerned, what proportion of those exports would not have occurred in the absence of the IDB programme.

17. While the countries covered by the programme include some of the more industrialized of the developing countries, this in itself does not make the relatively low volume of export financing a matter for disappointment. Export markets for capital goods require to be built up, the products have to acquire a reputation, a tendency for consumer preference for capital goods from the developed countries has to be counteracted. Striking results should not, therefore, be expected in a three or four-year period. Further, there must be clarity as to what any programme of export financing can or cannot do. It can, and does, improve the competitiveness of Latin American exports, as regards credit conditions. This is important for commodities, in which exports on credit are a normal feature, and where suppliers tend to compete not only in terms of price and quality but also in terms of favourable credit. However, an export financing programme cannot offset completely all other causes of lack of competitiveness that may inhibit capital goods export from developing countries.

18. The question can be raised that the IDB programme does not make available a new facility to exporters, but only strengthens the financial position of national agencies already engaged in the business of export financing. In fact, the programme has stimulated the development of existing national export finance facilities and the establishment of new ones.

TABLE 1

Operations under the programme as of 30 September 1967

($US thousand)

	Year of line of credit contract	*Amount authorized*	*Amounts disbursed*			*Amounts available*	
			As of 30 September 1966	*In 1966/67*	*As of 30 September 1967*	*As of 30 September 1966*	*As of 30 September 1967*
Banco Central, Argentina	1964	3,000	1,502	1,072	2,574	1,827	1,318
Banco do Brasil	1964	5,000	1,482	1,371	2,853	1,705	3,336
Banco do Brasil (special)	1966	10,780	—	—	—	10,780	10,780
Banco Central, Chile	1964	2,000	—	—	—	2,000	2,000
Nacional Financiera, Mexico	1964	5,000	3,163	2,973	6,136	2,039	214
Banco Nacional, Nicaragua	1966	1,000	—	—	—	1,000	1,000
Banco Industrial,[a] Peru	1965	185	270	—	270	754	—
TOTAL		26,965	6,417	5,416	11,833	20,105	18,648

NOTE: Amounts disbursed can exceed those authorized, since repayments can be further utilized. For the same reason, amounts available plus amounts disbursed can exceed amounts authorized.

[a] This line of credit originally was for $1 million, but was cancelled in June 1967.

TABLE 2

Cumulative value of exports financed by the programme: direction of trade as of 30 September 1967
($US thousand)

Importing countries	Exporting countries: Argentina	Brazil	Mexico	Peru	Total	Percentage
Argentina	—	3,679.1	5,029.2	—	8,708.3	46.01
Bolivia	80.0	122.9	—	—	202.9	1.07
Brazil	56.8	—	—	—	56.8	0.30
Colombia	9.4	—	—	—	9.4	0.05
Costa Rica	—	23.8	996.3	—	1,020.1	5.39
Chile	3,292.9	100.1	1,337.1	—	4,730.1	24.99
El Salvador	—	50.5	71.2	—	121.8	0.64
Guatemala	—	126.9	—	—	126.9	0.70
Honduras	—	137.4	258.7	—	396.0	2.09
Mexico	90.1	108.5	—	—	198.6	1.05
Panama	—	—	—	478.5	478.5	2.53
Paraguay	14.2	92.5	—	—	106.7	0.56
Peru	589.4	40.7	1,142.3	—	1,772.4	9.35
Uruguay	40.9	71.5	—	—	112.4	0.60
Venezuela	431.7	—	453.0	—	884.7	4.67
TOTAL	4,605.5	4,553.9	9,287.8	478.5	18,925.7	100.00
Percentage	24.33	24.07	49.07	2.53	100.00	

TABLE 3

Cumulative Brazilian exports financed by the programme as of 30 September 1967
($US thousand)

	Automotive vehicles[a]	Automotive steaming equipment	Road building equipment and tractors	Industrial machinery and equipment	Machine tools	Steel sheets	Total
Argentina	757.3	1,311.0	847.7	428.7	113.8	115.2	
Bolivia	90.3	—	32.4	—	—	—	
Chile	—	—	67.0	—	33.1	—	
Costa Rica	23.8	—	—	—	—	—	
El Salvador	50.5	—	—	—	—	—	
Guatemala	126.7	—	—	—	—	—	
Honduras	137.2	—	—	—	—	—	
Mexico	—	—	—	46.9	61.7	—	
Paraguay	84.9	—	—	—	7.6	—	
Peru	—	—	—	—	40.6	—	
Uruguay	71.5	—	—	—	—	—	
TOTAL	1,342.2	1,311.0	947.1	475.6	256.8	115.2	4,447.9
Percentage	30.2	29.5	21.3	10.7	5.8	2.5	100.0

[a] Includes trucks, light trucks, forklift trucks, buses, chassis, cabins, jeeps, diesel motor injector pumps.

TABLE 4

Cumulative Mexican exports financed by the programme as of 30 September 1967

($US thousand)

	Petrochemical industry equipment [a]	*Tubes*	*Flour-milling equipment*	*Ships*	*Boilers*	*Other equipment*	*Total*
Argentina	4,361	667	—	—	—	—	
Costa Rica	—	—	996	—	—	—	
Chile	—	1,139	—	198	—	—	
El Salvador	—	—	—	—	—	71	
Honduras	—	—	—	—	259	—	
Peru	—	1,143	—	—	—	—	
Venezuela	—	—	—	453	—	—	
TOTAL	4,361	2,949	996	651	259	71	9,287
Percentage	47.0	31.7	10.7	7.0	2.8	0.8	100.0

[a] Includes heat exchangers, distillation towers and columns, pressure tanks, storage tanks, large diameter steel pipes, prefabricated piping, steel bridle clamps and pipe connexions, metal forms.

MOBILIZATION OF INTERNAL RESOURCES AND ASSESSMENT OF PERFORMANCE OF DEVELOPING COUNTRIES

DOCUMENT TD/7/SUPP.2 *

Mobilization of internal resources by the developing countries
Study by the UNCTAD secretariat

[Original text: English]
[15 September 1967]

CONTENTS

Introduction

1. The first session of the United Nations Conference on Trade and Development laid considerable emphasis on the interdependence of the mobilization of domestic and external resources in the development process.[1] Mobilization of resources involves action to increase the supply of those factors which are considered to be of crucial importance in the growth process. The factors critical for economic growth vary not only from country to country but also for the same country at different stages of its development. Since there are considerable differences in the level of development among various developing countries, no single list of critical factors would be applicable to all of them. Even were it possible to compile such a list, the relative importance of various factors in the list would still vary from one country to another. Therefore the comparative economic performance of various developing countries cannot be assessed on the basis of any single set of factors. However, there is at the same time widespread agreement on the broad outlines of an effective development policy and this is reflected in the guidelines adopted by the first session of the Conference in that respect.[2]

2. In what follows, attention is focused on some of the areas which, as those guidelines indicate, are considered of crucial importance for any evaluation of self-help performance: namely, trends in output, investment and savings, the growth of the agricultural sector, the development of education and technical skills, and the effectiveness of the planning process. Developments in those

* This study is a revised version of document TD/B/C.3/28 issued on 26 January 1967 for the second session of the Committee on Invisibles and Financing related to Trade and incorporates document TD/7/Supp.2/Corr.1.

[1] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I: *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 42, A.IV.1, para. 1*(a)*(ii).

[2] *Ibid.*

fields are reviewed so as to give a general indication of the measure of progress achieved.[3]

3. A major conclusion of the study is that, despite important failures and short-comings, notably in the sphere of agriculture, significant progress over a broad front has been made in a considerable number of developing countries. The evidence set forth in the study shows that many of these countries are making better use of their own resources than they were some years ago, and that their ability to utilize external resources productively has advanced accordingly. As pointed out recently by the Chairman of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD), "there can be little question but that the rate of change will be accelerated if the flow of foreign capital and technical assistance are increased in volume and effectiveness".[4]

4. The available estimates show that a considerable number of developing countries attained an average annual rate of growth of real gross domestic product of 5 per cent or more during 1960-1966. In addition, in a number of other countries, the rate of growth realized during 1960-1966 was higher than that of 1950-1960. However, the weighted average rate of growth of the developing countries as a whole during the period 1960-1966 was lower than 5 per cent—the target of the United Nations Development Decade.

5. It would appear that the developing countries need to invest 15 to 20 per cent of their annual gross income in order to sustain an annual growth rate of 5 per cent. The available estimates for fifty-four countries indicate that in thirty-seven cases gross domestic capital formation amounted to 15 per cent or more of gross domestic product in 1963-1965. In a considerable number of countries, real gross investment increased at an average annual rate of 7.5 per cent or more during the period 1950-1965.

6. It appears from the foregoing that a rate of domestic savings of at least 15 per cent of gross income would be a necessary condition for self-sustained growth in the developing countries. Available data for fifty-four developing countries show that, during 1963-1965, twenty-three of those countries saved 15 per cent or more of their gross domestic product. At the same time, of the thirty-eight countries for which statistically significant estimates of marginal savings rates were obtained for the period 1950-1965, twenty-three had a marginal annual savings rate of 15 per cent or more.

7. Although the data on the sectoral composition of domestic savings are imperfect, it appears that, in a majority of developing countries for which information is available, government savings are neither the most important nor a fast growing component of domestic savings. In most countries, the bulk of savings seems to be expected in the private sector. The private sector also seems to be the major source of the increases in net domestic savings ratios recorded in the decade ending in 1964.

8. The relative insignificance of public savings in the developing countries is partly due to ineffective tax systems. These are dominated by indirect taxes, which in many cases tend to be relatively income inelastic in yield and inequitable in incidence. Lack of effective administration leads to considerable evasion of direct taxes. Agricultural taxation in many developing countries also needs reform in the interest both of equity and of efficiency.

9. Despite these obvious defects, tax revenue in a majority of developing countries for which estimates are available rose faster than gross domestic product over the period 1950-1965. Of twenty-eight developing countries for which statistically significant estimates of the income elasticity of tax revenue were obtained, twenty-one countries had income elasticities of greater than one. However, in a majority of countries, the growth of current government expenditure seems to have wholly absorbed the additional tax revenue, so that the public savings potential was not realized in those cases. It should be borne in mind that current government expenditure includes outlays for education and health, which contribute to development.

10. *Per capita* agricultural production in the developing regions of the world as a whole tended to stagnate in the 1960's and data for 1965-1966 indicate a sharp decline. However, taking the period 1948-1963 as a whole, the growth of total agricultural output in the developing regions does not compare unfavourably with that of the developed regions of the world.

11. Developing countries recognize that attempts to increase agricultural production can be frustrated by such institutional obstacles as inefficient and inequitable systems of land ownership or land tenure practices. Many of them have enacted land reform legislation, although it appears that implementation has not been very effective.

12. Improvements in agricultural technology are an important source of increased agricultural production. Progress is being made in this respect by the developing countries, although the use of modern practices such as the application of fertilizers is still confined largely to limited sectors of agriculture such as plantations or export crops.

13. The developing countries are critically short of many types of technical skills. As a result, they are putting increasing emphasis on education and training. Judging by the trends in enrolment, there has been a significant advance at all three levels of education during the past decade. However, progress in terms of effective schooling is not considered satisfactory due to a high drop-out ratio. There is also increasing concern that educational programmes should be so planned as to reflect the requirements of social and economic development.

[3] It must be emphasized that, while the indicators provided in this study are useful in assessing performance, they do not by themselves exhaust the information required for evaluating a country's over-all economic performance or for comparing it to that of other countries. Such a task would require a detailed investigation of resource endowment, economic structure and potentialities, and the initial level of development. Moreover, some of the important elements of progress, such as the building and strengthening of a favourable institutional framework, cannot be quantified.

[4] OECD, *Development Assistance Efforts and Policies, 1966 Review* (Paris, 1966), p. 25.

14. Planning has come to be widely accepted as an indispensable tool for accelerating the pace of development. Development planning is currently applied by most of the developing countries, although its form, objectives and effectiveness vary considerably from one country to another. In a number of countries, implementation of plans, particularly in agriculture, is far from satisfactory. However, it appears that, despite considerable handicaps on account of political difficulties, institutional rigidities and other factors, planning is serving a useful purpose in improving the economic management of the countries concerned and the quality of planning is itself gradually improving over time.

15. In the interests of their development, it is essential that developing countries should undertake an adequate mobilization of their internal resources. Such mobilization is important not only in itself, but also in order to make possible the most effective use of external resources as well. However, a country's economic performance is influenced by many factors, not all of which may be amenable to government control. Thus meaningful performance norms cannot be established without a detailed evaluation of structural characteristics, potentialities and constraints which condition the pace of development of each country. An impartial expert evaluation of plans and performance on a continuing basis would help greatly in evolving an effective international development policy. Such a procedure would assure donor countries that their aid was being put to good use without requiring them to set up their own evaluation machinery, a task for which only a few major donor countries are adequately equipped. At the same time, it would also help to foster the growth of the idea that the sole object of economic aid should be to promote economic development.

Chapter I

Growth rates of output

16. The growth rate of aggregate output is usually regarded as a convenient way of summing up a country's over-all economic performance. A country's current performance may be assessed either by comparison with performance of other countries during the same period or on the basis of its own past performance. Both these methods have their advantages and limitations.

17. A cross-section approach covering a number of countries may give a general indication of relative performance, provided that too much importance is not given to relatively small inter-country differences. Moreover, in comparing one country with another it is essential to bear in mind basic structural differences or factors outside the control of the countries concerned. For example, if two countries start from different initial points with respect to the size of *per capita* income or the utilization of existing productive capacity, differences in their rates of growth may be at least partly the result of factors unrelated to performance. Observed differences in growth rates among countries may also be due to the varying incidence of natural calamities or of unforeseen fluctuations in prices and in the volume of exports. Furthermore, in some cases the divergences in the rates of growth of output may partly be accounted for by differences in the inflow of external assistance. At times, differences in rates of growth of output may reflect differences in basic development strategies. For example, a country may deliberately choose a strategy which initially yields a lower rate of growth but is considered more profitable over a longer period. In such cases, differences in growth rates during any given period need not reflect comparative performance.

18. A time series analysis of growth rates makes it possible to assess a country's current performance against its own past rate of growth. Thus a high or rising rate of growth is *prima facie* an indicator of good performance. But even in this case caution is required in drawing inferences about performance from the observed behaviour of growth rates over time. Both an acceleration and a decline in the rate of growth over time may be the results of factors having no bearing on performance, such as fluctuations in harvest yields in response to sudden changes in weather or changes in the volume and prices of exports on account of events in the outside world.[5] Thus the rate of growth of aggregate output, although a useful starting point in the analysis of performance, is not a sure basis of judgement on comparative performance.

19. Information regarding rates of growth of real gross domestic product in the developing countries during 1950-1960 and 1960-1966 is summarized in table 1.[6] Two facts emerge from an examination of this table. First, twenty-three out of forty-four countries for which data for both periods are available achieved on the average a higher rate of growth during 1960-1966 than in 1950-1960; in nineteen of the twenty-three countries the acceleration of the growth rate exceeded 1 per cent. Secondly, judging in terms of the target set for the United Nations Development Decade, the following twenty countries achieved average annual growth rates of 5 per cent or more during 1960-1966: Bolivia, China (Taiwan), Greece, Guatemala, Iran, Iraq, Israel, Jordan, Malaysia, Mexico, Nicaragua, Nigeria, Pakistan, Panama, Peru, Republic of Korea, Thailand, Trinidad and Tobago, Venezuela and Zambia. In addition, Syria and the United Arab Republic, for which data are not yet available for 1966, recorded average annual growth rates of more than 5 per cent during 1960-1965. However, despite significant progress in those countries, many other developing countries failed to realize the annual target growth rate of 5 per cent. What is perhaps more significant is the fact that the latter group included countries with large populations such as Argentina, Brazil, India and Indonesia.

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[5] For example, the average annual rate of growth achieved by India during 1960-1964 was 4.4 per cent. It compared favourably with the average annual rate of growth of 3.7 per cent of the 1950's. However, because of an unprecedented drought in 1965, total output declined by over 4 per cent in 1965, pulling down the annual average for 1960-1965 to 2.7 per cent.

[6] For some of the countries included in table 1, the data relate to 1955-1960 and 1960-1965 instead of 1950-1960 and 1960-1966 respectively.

Chapter II

Level and trend of investment

20. From the point of view of economic policy, investment stands out as one of the instruments of growth most readily influenced or controlled. Although there are other sources of growth, the significance of investment lies in the fact that it not only adds to productive capacity but also provides the means for the transmission of technical progress. Even improvements in organization and skills gained through "learning by doing" are influenced by the rate of investment. Furthermore, a high rate of investment adds to the flexibility of the economy and facilitates its structural adaptation to changes in the economic environment.

21. Despite the great importance of investment in the process of growth, there need be no unique relationship between an increase in investment and the growth of output. The contribution that a unit of investment makes to increased output depends on a number of factors such as efficiency in the selection, design and execution of investment projects as well as the effectiveness with which capital and other co-operating factors of production are combined in the productive process. Furthermore, higher investment will not lead to an increase in output if the additional productive capacity cannot be utilized either because of an unexpected deficiency of demand or because of a failure to make adequate provision for the supply of raw materials and intermediate products needed to set the productive capacity into motion. Besides, as is well known, the observed values of the aggregate incremental capital-output ratios are also influenced by the sectoral distribution of total investment as well as by the existence of excess capacity, if any, in the system to start with. Furthermore, at times the underlying relationship between investment and output may be obscured by the sudden emergence of such factors as fluctuations in harvest yields. For all these reasons, it appears that countries with the same investment ratios do not always experience the same rate of growth of output. However, all this does not detract from the strategic role of investment in the growth process. Investment is no doubt a necessary although not always a sufficient condition of sustained economic growth.

22. In interpreting statistics on investment and savings of the developing countries, the unreliability of the available estimates, especially those relating to the rural sector, must be borne in mind. International comparisons of investment rates are subject to an additional difficulty, in so far as relative prices of investment goods may vary from one country to another. For want of data, it has not been possible in this study to make allowances for these factors. The available data on rates of gross domestic capital formation in the developing countries during 1963-1965 are presented in table 2. Of the fifty-four countries included in that table, twenty-nine were devoting 15 to 20 per cent of their gross domestic product to capital formation during the early 1960's and eight other countries had achieved investment rates of over 20 per cent during that period.

23. Rates of growth of real gross investment during the period 1950-1965 have also been impressive in a considerable number of countries. Table 3 shows that, of the forty-one countries for which statistically significant results were obtained, sixteen managed to increase real investment at an average annual rate of 7.5 per cent or more during that period; in fourteen other countries the average annual rate was in the range of 5 to 7.5 per cent.

24. The adequacy of any given rate of investment may be assessed in terms of target rates of growth of output and the probable values of the incremental capital-output ratio. Of forty-one developing countries for which incremental capital-output ratios were calculated for the period 1950-1965, all but seven had ratios in the range of 3 to 4. That would suggest that those countries needed to invest 15 per cent or more of their income in order to realize the United Nations Development Decade annual target growth rate of 5 per cent. Investment ratios in two-thirds of the developing countries listed in table 2 lie in that range.

25. The observed trend of investment is a useful indicator of the intensity of the development effort but differences in rates of capital formation may also be due to factors unrelated to self-help measures. In so far as a part of capital formation is financed through external aid, differences in rates of investment may simply reflect different flows of aid. It is therefore of interest to examine the magnitude of the domestic savings effort.

Chapter III

Mobilization of domestic savings

Savings and economic development

26. It is generally agreed that the pace of economic development is associated, among other things, with the growth of savings. This is because an act of saving makes possible the release of productive resources from consumption which may then be utilized to add to the stock of productive capital, thereby promoting the expansion of output.

27. It is for this reason that much has been made of various measures of savings as a key to the self-help performance of developing countries. A country is considered to be doing well if the ratio of its domestic savings to its total output is high, or at least rising. Conversely, a low or falling savings ratio is often regarded as evidence of insufficient domestic effort.

28. Inferences along these lines would be reasonable if the effort to save more were all that was needed to bring about a higher level of investment. In fact, however, attempts to raise the level of savings may be frustrated in at least two ways.

29. In the first place, a reduction in consumption will help to raise savings only if total output is not adversely affected thereby, and the resources released from consumption are in fact utilized for additional investment.

30. Where the additional savings are generated through higher tax revenues, and are used directly by the public sector for stepping up its own investment, no problem

would arise.[7] But where there is a spontaneous reduction in private consumption unaccompanied by a rise in public investment, this does not in the least imply that entrepreneurs would thereby be induced to add to their original planned level of investment. And if they did not do so, the effect of the fall in consumption would be to reduce total output and income to the point at which savings were no greater than the original planned level of investment. In these circumstances, the effort to save more would fail.

31. Indeed, an increase in the desire to save (a cut in private consumption) could, in certain circumstances, bring about a reduction in the volume of savings actually realized. That would occur if the fall in consumption led to a downward revision of the original investment plans owing to a decline in business expectations.

32. Attempts to save more could also be frustrated if it proved impossible to translate the additional savings into the investment goods required. Since the capacity of developing countries to manufacture capital goods is generally limited, the conversion of domestic savings into additional investment usually involves some increase in imports of machinery and equipment. But such an increase in imports may not be possible unless the fall in domestic consumption has the effect of adding sufficiently to the supplies—and sales abroad—of exportable goods or of reducing other demands for imported goods.

33. Since the commodities exported by developing countries are highly specialized and do not usually figure prominently in domestic consumption,[8] a fall in total consumption would not generally affect export earnings significantly. And since the import content of investment expenditure is normally much higher for these countries than that of consumer expenditure, a fall in consumer expenditure would not release sufficient foreign exchange resources to pay for the additional imports associated with an equivalent amount of additional investment.

34. If, as a result of this balance of payments constraint, the rise in investment falls short of the planned additional savings, the effort to increase savings will once again be partially frustrated ; it will lead to idle capacity and an aggravated under-utilization of resources.

35. Thus a low or falling level of savings does not provide a clear indication of inadequate effort or performance ; and a high or rising level of savings is no proof of good effort or performance. Apart from the fact that savings may be low simply because income is low, " insufficient " savings may reflect not any absence of willingness to save, but a lack of suitable investment opportunities, or an inability to earn sufficient foreign exchange. Under such conditions, it would be quite irrational for a country to seek to raise its propensity to save even although it had the capacity to do so.

36. Declining savings may also reflect a fall in export earnings resulting from a drop in commodity prices, just as rising savings may be merely the counterpart of an increase in commodity prices. Here the fall in savings may result directly from the setback in total income, or indirectly from an enforced curtailment of imports of investment goods, or of raw materials and components, tending to depress total output and income still further.

37. It will be evident, therefore, that savings performance requires a much more careful analysis than it sometimes gets in the course of efforts to appraise the degree to which countries are helping themselves. It will not be possible, within the compass of the present paper, to undertake the type of case-by-case examination that would be needed to fulfil this kind of task properly. The present paper does not, therefore, go much beyond a review of certain of the well-known aggregate measures.

38. Generally, it is to be expected that the level of savings would rise as development proceeds, on account of the increase in the surplus of *per capita* income over minimum subsistence needs and also because of the progressive disappearance of rigidities in the structure of domestic production. Since income *per capita* may be taken as a rough index of these two factors, a comparison has been made of levels of *per capita* income and *per capita* savings in thirty-one developing countries for which the relevant data were available. The results[9] indicate a strong relationship between these two variables, as well as a strong and statistically significant tendency for the marginal rate of savings to increase with *per capita* income.

Gross domestic savings rates 1963-1965 and marginal savings rates 1950-1965

39. It was suggested earlier that the developing countries would need to invest 15 to 20 per cent of their income in order to realize the 5 per cent growth target of the United Nations Development Decade. Thus a rate of domestic savings of at least 15 per cent of gross income would appear to be a necessary condition for self-sustained growth at a satisfactory rate in the developing countries.[10]

[7] The additional public savings would probably be accompanied by a decline in private savings, but since the additional taxation would also impinge upon consumption, total domestic savings would increase.

[8] There are some exceptions to this, notably in the case of countries which export products that are important items of domestic consumption, such as meat or textiles, However, even as regards some of these commodities, notably textiles, a fall in domestic consumption will not always be reflected in a rise in the value of exports, as the latter may be limited by import restrictions in the major markets rather than by productive capacity in the exporting countries.

[9] The relationship tested and the results obtained from regression analysis for thirty-one developing countries are as follows:

$$\frac{S_t}{P_t} = 14.4 - 0.0207\,\frac{(Y_t)}{P_t} + 0.000223\,\frac{(Y_t)^2}{P_t}$$

where S_t/P_t = Gross Domestic Savings *per capita* in period t
Y_t/P_t = Gross Domestic Product *per capita* in period t
The values of the above coefficients relate to a cross-country test for the year 1960. Cross-country tests for all sample countries with data relating to the years 1955 and 1958 as well as for regional sub-samples have yielded very similar results.

[10] In so far as a part of domestic savings has to be earmarked for meeting the service obligations on accumulated external debt, the domestic savings rate must exceed the rate of domestic capital formation by the full amount of debt service charges if self-sustained growth is to be achieved.

40. Data on savings are among the least reliable in all countries, and the developing countries are no exception. However, judging by the available data presented in table 4, a considerable number of developing countries are currently saving 15 per cent or more of their annual gross domestic product. Of the fifty-four countries included in table 4, eight were saving less than 10 per cent of their gross domestic product during the early 1960's; twenty-three countries saved 10 to 15 per cent; eleven countries attained a savings rate of 15 to 20 per cent; and twelve countries had a savings rate of 20 per cent or more. Of the thirty-seven countries shown in table 2 as devoting 15 per cent or more of their gross domestic product to investment in the early 1960s, nineteen also recorded domestic savings of 15 per cent or more of total output.

41. Since developing countries are not all at the same stage of economic development or level of *per capita* income,[11] and also because they did not all start their development programmes at the same time, it would not be appropriate to measure their commitment to self-help by reference only to rates of gross domestic savings attained in a given time period. From this point of view, the behaviour of the marginal rather than of the average savings rate of a country may be a better indicator of the speed with which it is adapting itself to growing investment opportunities. Accordingly, marginal savings rates were computed for forty-seven developing countries covering the period 1950-1965, of which results for thirty-eight countries turned out to be statistically significant. Of these thirty-eight countries, twenty-three had a marginal annual savings rate of 15 per cent or more (table 5).

Sectoral composition of domestic savings

42. A sectoral breakdown of total savings may throw light on the pattern and quality of investment, especially where capital markets are underdeveloped or where there are other difficulties in making the savings of one sector available to finance worth-while projects in another sector. For example, if household savings are not made available to finance productive investments in the business sector but are earmarked for luxury construction or for speculative investment in such things as gold or jewellery, the growth of output is bound to be affected.

43. Unfortunately, for lack of data it is not possible to analyse the sectoral composition of savings in all developing countries. Even where figures are available, they are often not internationally comparable; in some countries, savings of government commercial enterprises are merged with general government savings, while in others they are included in corporate savings. However, judging by the available figures, government savings appear to be neither the most important component of total savings nor are they growing particularly fast in the majority of the developing countries for which information is available.[12] With a few exceptions, private savings seem to constitute the most important component of domestic savings in the developing countries. It also appears that the private sector was largely responsible for the increases in net savings ratios recorded in the decade ending in 1964.[13]

44. The available data on private savings do not indicate the relative importance of personal and business savings. Household savings as defined in statistics of national accounts also include savings of unincorporated enterprises which account for a sizeable part of business activity in many developing countries. As is well known, motives for business savings are different from those for personal savings. Although it is not possible statistically to divide total private savings into personal and business savings, the available evidence suggests that in most developing countries the latter constitute a far larger contribution than the former to total domestic savings available for productive investment. In some countries, the bulk of private savings is accounted for by the corporate business sector.

45. The share of public savings in total savings is partly dependent on the relative importance of public investment in the development strategy of a country. This is essentially a political decision. As such, the relative share of public savings in total savings will vary from country to country.[14] However, many developing countries have assigned a growing role to public investment in their development strategy. In the absence of adequate public savings, public investment can be financed by borrowing either at home or abroad. Borrowing abroad is subject to major limitations, as shown in other papers before the Conference. The scope for internal borrowing is, however, also limited by the often primitive nature of capital markets in the developing countries and by the risk of inflation, especially in view of the rigidities characteristic of the economic structure of those countries. It is therefore important to study

[11] It should be noted that savings depend not only on the level of *per capita* income but also on the distribution of income.

[12] "In most developing countries, 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." United Nations *World Economic Survey, 1965*, part I (United Nations publication, Sales No.: 66.II.C.1), chap. I, p. 21.

[13] *Ibid.*

[14] For a number of reasons, the relative share of public savings in various developing countries cannot form the basis of assessing their comparative performance. First, as pointed out above, the share of public savings is at least partly influenced by the political decision concerning the role of public investment in total investment. Since there is no precise relationship between the size of public investment and the pace of development of an economy, the relative size of public savings need have no close relation to successful growth performance. Moreover, conventional definitions of consumption, investment and savings do not provide a true indication of the relative productivity of various types of government expenditure. Some items of government current expenditure, such as education and health, may be as productive as government investment as conventionally defined. Thus the relative size of public savings, as usually measured, may not adequately reflect a Government's commitment to self-help.

carefully the means by which the share of public sector savings in total income can be increased. Of course, in order to secure optimum results, such an increase should be achieved in such a way as to avoid unfavourable effects on productive investment in the private sector.

The tax structure

46. Public savings in the developing countries are bound to remain small if their tax-income ratios are not substantially raised. In the developed market economies, taxes on the average absorb about 30 per cent of the annual gross domestic product.[15] On the other hand, of the thirty-three developing countries for which data are set forth in table 6, only fifteen show tax revenue exceeding 15 per cent of their gross domestic product[16] in the early 1960's.

47. No doubt, the taxable capacity of the developing economies is lower than that of the developed countries on account of their much lower *per capita* income, which means that they have a much smaller surplus over minimum essential consumption. Also, when a large part of the national income of a country accrues to the subsistence sector, it cannot be easily identified for tax purposes. However, considering the great inequalities of income and wealth to be found in many developing countries and also the well-known defects in their tax legislation and administration, it is unlikely that their current tax revenues reflect their full tax potential.

48. The existing tax structure in many developing countries is not conducive to a rapid growth of tax revenues unless there are frequent changes in coverage and rate of taxation. Of the thirty-three countries included in table 6, nine had lower ratios of tax revenue to gross domestic product in 1963-1965 than in 1955-1957. In the developed market economies, tax revenue tends to rise faster than national income even without a revision of the rate structure. This is due to the importance of progressive taxes on income and wealth in their tax structure. In the early 1960s, indirect taxes accounted for about 35 to 50 per cent of total tax revenue in the developed countries of Western Europe and North America. During the same period, of the thirty-two developing countries included in table 7, only twelve collected less than 60 per cent of their total tax revenue through indirect taxation. The majority of developing countries collect about 70 per cent or more of their tax revenue from indirect taxes. However, it appears that, in a number of countries, the share of indirect taxes in total tax revenue is gradually declining.

[15] During 1962-1964, tax revenue was equivalent to 28 per cent of the gross domestic product in the United States; 29 per cent in the United Kingdom; 35 per cent in the Federal Republic of Germany; 37 per cent in France, and 26 per cent in Canada.

[16] Inter-country differences in the ratio of tax revenue to gross domestic product may reflect factors other than the willingness to mobilize resources for development. They may, for example, be due to different conceptions of the role of government in economic activity or to differences in the proportions of income accruing in sectors that are relatively easy to identify for tax purposes. The contribution of customs duties, which are relatively easy to collect, will depend on the ratio of imports to total income.

49. Since many indirect taxes tend to be both regressive in incidence and inelastic in yield as income rises, their preponderance in the tax structure of the developing countries calls for frequent revisions of basic rate structure if the share of tax revenue in total income is to be maintained. Of course, it is sometimes possible to build into a system of indirect taxation a certain degree of progressivity, as through progressive excise taxes, whereby articles of mass consumption are either exempt or are taxed at lower rates than luxuries. Also, when inequalities of income and wealth are not very serious and the administrative system is so poor that income taxes are easily avoided, indirect taxes may be an equitable method of distributing the tax burden. Thus customs duties may be the only practicable way of taxing peasant incomes or urban consumers where they cannot be reached through income taxes. But when there are considerable economic inequalities, indirect taxes are generally less equitable and effective than progressive taxes on income and wealth, and exert less restraint on socially wasteful consumption. Clearly, there is need in most developing countries to superimpose on the existing indirect taxes an effective system of progressive taxation of income and wealth, and to train the officials required to administer such a system.

50. Most developing countries levy direct taxes on income, but because of defective legislation and inefficient administration, tax collections fall far short of amounts legally due.[17] In many Latin American countries, apart from the general problem of evasion, there is no single comprehensive tax on all income but the cedular system of income taxation which leaves many important sources untaxed. In addition, exemption levels tend to be higher than they need be. In some Asian developing countries, for example, personal incomes up to a multiple of ten to twenty times the average *per capita* income remain altogether exempt from income taxes, whereas the corresponding multiple is one to three in most developed market economies.[18] Lack of administrative personnel sometimes stands in the way of lowering exemption limits, but other methods can be found to tax the growing class of industrial and urban workers. In this connexion, the role of parafiscal devices, such as compulsory contributions for social insurance and pensions, can be very significant. It appears that in the United Arab Republic the increase in savings in recent years has been in large measure the result of such parafiscal devices.[19]

[17] According to estimates of the Central Board of Revenues of India, 30 per cent of income assessable to income tax evaded taxation in 1955-1956.

Argentina's central bank estimated under-reporting of income to be 50 per cent in 1952 and 60 per cent in 1957. Income assessed to complementary tax in Chile was estimated to have been under-reported by 65 per cent in 1956. Cf. R.C. Desai, "Fiscal Capacity of Developing Economies," in *Fiscal Policy for Economic Growth in Latin America* (Baltimore, Md., Johns Hopkins Press, 1965), p. 43.

[18] Economic Commission for Asia and the Far East (ECAFE), *Economic Survey of Asia and the Far East, 1960* (United Nations publication, Sales No.: 61.II.F.1), p. 94.

[19] See Jorgen R. Lotz, "Taxation in the United Arab Republic (Egypt)," *IMF Staff Papers*, vol. XIII, No. 1, March 1966.

51. In developing countries, the proportion of total income generated in agriculture is relatively high. It is not easy to calculate the burden of taxation borne by agriculture because of difficulties in allocating indirect taxes among various sectors of the economy. However, there is general agreement among experts that agriculture is rather lightly taxed in developing economies. In Asia, the burden represented by the traditional land tax has progressively declined as agricultural prices have risen and reassessments have not been frequent.[20] In Latin America, according to H. P. Wald, " except in a few countries which seem to have been moderately successful with export taxes on agricultural products, the prevailing taxes on Latin American agriculture are generally primitive in form, poorly administered, and productive of almost negligible amounts of revenue ".[21] He goes on to add : " From every point of view—equity, revenue need and economic effects—this is an unmistakably damaging state of affairs. The tax shelter enjoyed by wealthy landlords in most Latin American countries, paradoxically enough, impedes agricultural development and more generally exerts a drag on over-all economic progress in the region. "[22] In a recent analysis of taxation in tropical Africa, J. F. Due comes to the conclusion that, " while African countries do not have the large land-holdings problem characteristic of some underdeveloped countries, the general field of land taxation offers perhaps the greatest opportunity for improvements in their tax structure. However, before this can be accomplished, registry of rights of ownership or use of land surveys are required ".[23] Of course, one must not underestimate the political and administrative difficulties in taxing agriculture, particularly when it is organized on a subsistence basis. Nevertheless, although agriculture may not lend itself to very advanced forms of taxation, a simple graduated tax on the basis of the size of the family holding, from which small holders can be exempted, may be administratively feasible.

52. Despite these obvious drawbacks in their tax structure, tax revenue in a number of developing countries has been rising faster than national income.[24] Thus of the twenty-eight countries included in table 8, twenty-one showed an income elasticity of tax revenue exceeding unity during 1950-1965. Yet in a large number of countries, the growth of current government expenditure seems to have consumed most of the additional tax revenues. For a great majority of countries listed in the table, the income elasticity of current government expenditure was equal to or higher than the elasticity of tax revenue as well as the elasticity of current government revenue (excluding current transfer receipts from abroad). As noted earlier, some items of current government expenditure such as education and health may contribute to economic development as much as, if not more than, physical capital formation. However, when the growth of current expenditure is due to increasing outlays on defence and general government administration, there is not likely to be much benefit for development.

[20] ECAFE, *op. cit.*, pp. 100 and 101.

[21] H.P. Wald, " Reform of Agricultural Taxation to Promote Economic Development in Latin America," in *Fiscal Policy for Economic Growth in Latin America* (Baltimore, Md., Johns Hopkins Press, 1965), p. 326.

[22] *Ibid.*

[23] J.F. Due, *Taxation and Economic Development in Tropical Africa* (Cambridge, Mass., Massachusetts Institute of Technology Press, 1963), p. 163.

[24] A high income elasticity of tax revenue may be due either to a built-in progressivity in the tax system or to frequent revisions of the rate structure. It has not been possible in this study to isolate the relative importance of the two factors. However, in view of the great importance of indirect taxes in the tax systems of developing countries it appears that revisions of rate structure may have been more important than the built-in progressivity of the tax system.

Chapter IV

Development of the agricultural sector

53. Agriculture often accounts for as much as one-half or more of the national income in developing countries. Although it is characteristic of the development process that the share of agriculture in total income tends to decline, this does not mean that the role of agriculture in development is a subordinate one. On the contrary, historical experience shows that overcoming agricultural backwardness is not less important than the development of industry, and that the generation of an adequate surplus by the agricultural sector is indispensable in stepping up over-all investment and growth. The danger of a world food shortage obviously emphasizes still further the importance of successful performance in the field of agriculture.

Growth of agricultural output in developing countries

54. Information on changes in total and *per capita* output of the agricultural sector since 1954/55 is set forth in table 9 and in the chart. The table indicates that, between 1954/55 and 1959/60, *per capita* agricultural production increased moderately in all developing regions[25] except Africa. *Per capita* production levelled off from 1959/60 to 1964/65 and estimates for 1965/66 suggest a sharp reduction in *per capita* output in that year.

55. To a considerable extent, these unfavourable developments were due to rapid, and in some cases accelerating, population growth. Trends in total output were not unimpressive—total agricultural production in the developing countries has risen no less than one-third since the mid-1950's.

56. Further, the over-all increase in production in developing countries does not compare unfavourably with that in the economically advanced nations. A study by the United States Department of Agriculture, *Changes in Agriculture in Twenty-six Developing Nations, 1948 to 1963*, found that, in the course of that period, "twelve of the twenty-six developing nations had compounded

[25] The classification established by the Food and Agriculture Organization of the United Nations (FAO) includes Cyprus, Japan, South Africa and Turkey among the developing regions and excludes Yugoslavia.

rates of increase in crop output of more than 4 per cent per year. These rates surpassed those ever achieved by now economically advanced nations during comparable periods of time. Rates of increase in crop output failed to exceed population growth rates in only five of the twenty-six countries". This summary should, however, be qualified in at least two respects. First, the data referred to do not include the production of livestock, which rose more slowly than that of field crops. Secondly, the study gives equal weight to small and large countries. It so happens, however, that small countries, on the average, raised their production more than the large countries.

57. The over-all and regional developments discussed above conceal very large differences among the various developing countries. Table 10 gives the average annual change in agricultural production in developing countries over the past decade. Out of thirty-two countries for which data are available, only two indicate a decline in production in absolute terms; however, owing to the rapid growth of population, *per capita* production declined in eleven out of thirty-two countries. On the other hand, a considerable number of countries were able to step up their *per capita* production significantly over this period.

58. It is usually assumed that the promotion of agricultural development is likely to save scarce foreign exchange and that such development does not itself call for heavy foreign exchange outlays because the import component of both investment and output in agriculture is lower than in the rest of the economy. This assumption is borne out by a number of development plans which analyse imports of capital goods by sectors of destination. Import content may be particularly low in the case of investments in research, training, extension, marketing and also investments accompanying land reform. Nevertheless, even if most of the needed capital goods are of simple design and can be produced locally, some of the capital goods and raw materials or intermediate products required for the local production of capital goods may call for imports.

59. Some agricultural investment projects involve quite heavy foreign exchange costs. The International Bank for Reconstruction and Development (IBRD) has estimated the average import content of the fifty-one agricultural projects financed by the Bank during the past decade or so at 36 per cent (see table 11). While it is not possible to determine how typical these projects are of agricultural investments generally as regards import content, the figure of 36 per cent does not differ substantially from the average import content of total capital formation in developing countries, which has been estimated at between 30 and 40 per cent.[26]

Land reform

60. It is now generally recognized in developing countries that increases in agricultural output depend upon the creation of a suitable institutional framework, which in many countries would necessitate land reform as well as an appropriate reorganization of the systems of farm credit and of the marketing of farm produce. Reform is oriented not so much to the problem of increasing output in the short run as to the broader social impact, whose effects on production may not emerge until much later. Land reform is regarded as an indispensable element in the development process in so far as it involves breaking feudal ties, redistributing land, freeing labour and improving the distribution of the national income.

61. While the need for reform is almost universal, the specific problems differ from region to region and from country to country. There are, however, a number of typical cases.

62. The problem in many Latin American countries lies in the polarization between a small number of large estates (*latifundia*) and the many small holdings (*minifundia*). The *minifundia* are usually farmed by impoverished peasants lacking the knowledge, the resources and the initiative to invest in improvement, and their holdings are often below the minimum size necessary for efficiency. The large estates, on the other hand, are farmed with the help of dependent and badly paid labourers. They provide their owners with a sufficiency of power and money, and the incentive to break away from traditional mores and methods so as to increase output is therefore very limited.

63. The Latin American countries have formally declared land reform to be an integral part of their development policies, through the charter of Punta del Este.[27] Nearly all Latin American countries have adopted measures to this end, although the results achieved do not generally add up to any basic change in the system of land tenure.[28]

64. In other developing regions, notably in Asia, the problem is usually one of tenancy systems, where shortage of land causes fragmentation and enables absentee landowners to exploit their farmers to a degree which leaves no resources or initiative for improvement. Any margin left to the farmer after he has paid his rent tends to find its way into the hands of the landowner for the supply of seed or credit. Most Asian Governments have adopted a policy of agrarian reform either in the form of land redistribution, with a ceiling to single holdings, or of some regulation of the tenancy itself.[29]

65. Finally, in many African countries, notably south of the Sahara, land ownership is communal to a large extent and the individual farmer may have no incentive to invest. Here there may be a need for land settlement and registration and some authorities consider that a system of private ownership is required. This is not the

[26] See United Nations, *World Economic Survey 1961*, part I (United Nations publication, Sales No.: 62.II.C.I), p. 23. The estimate includes capital formation for residential housing.

[27] See Alliance for Progress, Organization of American States, Washington, D.C., 1961, Official Records (OEA/SER.H/XII.1).

[28] See FAO, *The State of Food and Agriculture*, 1965, pp. 173-175; also United Nations, *Progress in Land Reform: Fourth Report* (United Nations publication, Sales No.: 66.IV.I), paras. 25-27.

[29] See FAO, *op. cit.* (1965), pp. 170-173.

only approach, however, and many experts prefer to preserve the communal elements or transform them into modern co-operatives.[30]

66. It seems that important attempts are being made by Governments in a majority of countries to enact land reform policies. Also, a number of basic principles are now widely accepted by Governments carrying out such policies. The question still is to what extent these policies, even if well understood, are effectively implemented. FAO reports that, while many laws have been passed, their implementation has often been incomplete. Major difficulties arise due often to lack of a comprehensive registration of land ownership and the lack of an administrative organization to carry out the reforms against the will of the existing land owners, who use all legal, technical and political means to oppose reform. Village organization is recognized more and more as indispensable to enlist the farmer's co-operation and interest in technical progress.

Agricultural technology

67. According to a recent FAO report although a good deal of the new agricultural technology is still confined almost entirely to the developed countries, many of the technological advances of the decade have also been put to use, at least to some extent, in the agricultures of the developing countries. That is the case with many of the results of plant breeding, improved pesticides and new methods of pest control.[31]

68. There are, however, important obstacles to the dissemination of the new technologies. Most agricultural research and technological innovation have taken place in the developed countries, where needs and conditions are different in both the agronomic and economic senses from those in the developing countries. Developed countries are mostly located in temperate zones while many developing countries are located in either tropical or much more arid regions. Many of the innovations introduced in the developed countries, therefore, are not easily applicable to conditions in the developing countries.

69. Economic conditions are also different. Much of the modernization of agriculture in developed countries is based on the need to save labour, while this is not a primary objective in developing countries. It does not follow that labour-saving techniques are of no relevance to developing countries if such techniques provide the best means of increasing output and the highest return per unit of capital invested. Nevertheless, the difference in factor endowments between developed and developing countries is likely to be an important factor in determining a suitable development strategy for agriculture.

70. The FAO report suggests further that the use of modern technology has grown rapidly in the developing countries but remains very limited ; furthermore, modern methods tend to be confined to limited sectors of agriculture such as sugar plantations or the production of crops for export. It is true that there has been a substantial increase in the use of fertilizers in developing countries from 1.5 to 4.2 million metric tons between 1954/55 and 1963/64.[32] Even so, the quantity of fertilizers per unit of arable land used in developed countries was still between four and twenty times higher than in developing countries in 1963/64, depending on the cases compared. The same rising trend but low absolute level applies to the use of tractors and other farm equipment in developing countries.

71. Yields have increased quite substantially in developing countries, but more slowly than in developed countries. About one-third of the increase in output in developing countries during the past decade is explained by higher yields, while in the case of developed countries higher yields account for the whole of the additional output.

Economic incentives

72. Some experts believe that existing agricultural development plans do not pay sufficient attention to policy measures which would induce the private sector to respond in line with plan targets. The farmer needs some degree of guarantee that prices will not fall below a minimum remunerative level if he is to be induced to increase production, and to invest in the farm. Governments have been reluctant to recognize this need and even when agricultural prices are stabilized, they are often fixed at a low level in the interests of the urban consumer or of general price stability.

73. This relative disregard of the need to make it worth-while for the farmer to introduce innovations and increase output is gradually disappearing. The FAO reports that " in more and more of these [developing] countries, however, it has come to be recognized that the assurance of stable and reasonably remunerative prices, effective at the farm level, is a prerequisite to increased production for the market. Many developing countries, therefore, have adopted policies of guaranteed or minimum farm prices, although, because of weaknesses in marketing structure and in local administration, few of them have yet succeeded in making price supports fully effective at the farm level. "[33]

Chapter V

Education and training

74. There is a growing realization among the developing countries that the quality of the human resources of a country is an important determinant of the pace of economic development and that, therefore, investment in human beings must go hand in hand with physical capital formation. In fact there is a considerable degree of complementarity between physical investment and expenditure on education and training, since the speed at which an economy can organize an expanding flow of profitable development projects and programmes is

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[30] See FAO, *op. cit.* (1965), pp. 176-177.

[31] *Ibid.*, p. 78.

[32] *Ibid.*, table VI-1, p. 93.

[33] *Ibid.*, p. 9.

greatly influenced by the availability of trained manpower.

75. The quantity and quality of trained manpower available to a country are largely dependent upon the level of its educational development.[34] However, in devising educational programmes, it is necessary to remember that some types of educational outlays may add much more to an economy's productive capacity than others. It is therefore essential that the educational system (its structure by level and type, its curricula etc.) should be adapted to the actual requirements of economic and social development. An efficient system of manpower planning is a great help in linking educational programmes to the future requirements of the economy. There is a general awareness in the developing countries of the need for manpower planning, although progress in that direction has been limited.

76. Subject to what has been said above, the total educational expenditure of a country expressed as a percentage of its gross national product would, if available, provide a rough and ready indicator of efforts being made by it to improve the quality of the educational attainments and skills of its human resources. Unfortunately, no reliable data are available along these lines: available data on expenditure by central governments on education underestimate the national expenditure, since in many developing countries both local authorities and the private sector make considerable outlays on education. However, the importance attached to educational progress in the developing countries is reflected in the fact that in eighteen out of twenty-five countries for which data are available the ratio of central government expenditure on education to gross national product rose significantly from 1960-1961 to 1963-1964; in another three cases the ratio was unchanged. Furthermore, according to estimates by the United Nations Educational, Scientific and Cultural Organization (UNESCO), the rate of growth of public educational expenditure in the developing countries in the 1950's was roughly three times the rate of growth of national income, starting of course from a low base of educational expenditure; public educational expenditure continued to grow in the eraly 1960's, starting from a higher base, at a rate generally somewhat more than twice that of national income (ignoring price changes in both cases).[35] The total cost of educational programmes in the developing countries in 1965 has been estimated by UNESCO to be 4.25 per cent of their combined gross national product and on present expectations it should rise to 5 per cent by 1970.

77. In terms of quantitative results, the data in table 12 point to a significant growth of enrolment at all three levels of education[36] in the developing countries.

78. The aim of free compulsory primary education is widely accepted by the Governments of the developing countries and considerable progress is being made in this direction. In the Asian developing region, the enrolment ratio[37] at the first level of education increased from 46 per cent in 1955 to 56 per cent in 1962 and the objective was to raise it to 63 per cent by 1965.[38] In Latin America in 1965 only five of the smaller countries had enrolment ratios of less than 90 per cent for the 7 to 12 age group,[39] although the situation is much less satisfactory in particular regions of the larger countries as well. For Africa as a whole, the enrolment ratio at the first level of education was less than 50 per cent in 1960. Although figures for later years are not yet available, a considerable increase probably occurred between 1960 and 1965, bringing the ratio close to the target ratio of 51 per cent by 1965.[40]

79. Although enrolment ratios at the first level of education show an encouraging trend, progress in terms of effective schooling is not considered satisfactory. Poverty and the lack of well equipped schools in rural areas are among the factors responsible for a high drop-out ratio. Thus in the developing Asian region as a whole, not more than 40 per cent of pupils entering grade one reach grade five.[41] In Latin America, only about 27 per cent of pupils who start primary education remain until the end of the cycle.[42] The corresponding estimate for Africa is 25 per cent.[43] Another major defect is that in most developing countries the enrolment ratio for females is much lower than for males.

80. Secondary education is often of strategic importance, for it governs the growth of primary education by providing teachers, of higher education by providing a flow of students and of the economy in general by supplying the middle-level manpower of which the developing countries stand in great need.

81. Despite considerable expansion of secondary education in Africa during the past decade, in 1965 only about 9 per cent of children between the ages of 15 and 19 attended schools and the ratio would be much lower if the United Arab Republic, which accounts for nearly 30 per cent of total enrolment in that continent, were to be excluded. At present, secondary schools in Africa can absorb only about 15 per cent of the graduates of primary schools. In the Asian developing region, the enrolment ratio for the region as a whole at the second level went up from 9 per cent in 1955 to nearly 15 per

[34] It must be borne in mind that the average level of education and skills of the labour force would fully respond to increased educational expenditures only after a time lag.

[35] UNESCO, *Unesco's contribution to the promotion of the aims and objectives of the United Nations Development Decade:* report by the Director-General, 14C/10, (Paris, 1966).

[36] The precise definitions of first, second and third levels of education vary from one country to another. However, generally they correspond to the more traditional terms primary, secondary and tertiary education.

[37] The enrolment ratio at any given level of education is defined as total enrolment at that level expressed as a percentage of total population in the age group corresponding to that level of education.

[38] ECAFE, *Economic Survey of Asia and the Far East, 1965* (United Nations publication, Sales No.: 66.II.F.1), p. 82. UNESCO, *op. cit.*, annex II, table 3.

[39] UNESCO, *Educational Developments in Latin America 1956-1965* (Minedecal/6).

[40] Richard Greenough, *Africa Prospect: Progress in Education*, Paris, UNESCO, 1966.

[41] ECAFE, *op. cit.*, p. 85.

[42] UNESCO, *Educational Developments in Latin America 1956-1965* (Minedecal/6).

[43] Richard Greenough, *op. cit.*

cent in 1965, although there are great variations among countries of the region. In Latin America as a whole, the enrolment ratio at the second level of education was about 16 per cent in 1960 and on existing trends should have reached about 22 per cent by 1965.

82. University education has also undergone a rapid expansion in the developing countries in the post-war years. The enrolment ratio at the third level of education in Asian developing countries taken together increased from 1.6 per cent in 1955 to 2.8 per cent in 1962.[44] In Latin America as a whole, this ratio went up from 3 per cent in 1956 to 3.7 per cent in 1965.[45] In Africa, the enrolment ratio at the third level is still less than 1 per cent for the continent as a whole, although there has been considerable expansion in the last decade.[46]

83. A major defect of the system of secondary and university education in the developing countries is that in many cases it is ill adapted to the needs of modern social and economic development and may largely reflect the structure and aspirations of the traditional society or of the former metropolitan Power. A recent United Nations survey of higher education in East Africa concludes that higher educational institutions in the sub-region have not sufficiently geared their activities and facilities towards accelerated development of high-level manpower resources as required by economic growth needs.[47] Similar criticism is heard in Latin America. In Asian countries, there is a general feeling that the educational system is still geared mainly to train students for the civil service rather than to meet needs for diversified skills generated in the process of development. Education in many countries is largely a means of access to the privileged class of public officials. Since the civil service has a limited capacity to absorb new graduates, graduate unemployment exists in some of the developing countries side by side with severe shortage of skilled manpower. The problem of an appropriate balance between general education and technical education is far from having been resolved. There has been a general neglect of agricultural education at the second level in spite of the great importance of agriculture in the economic life of most developing countries. As a result, rural extension services in most developing countries are severely hampered by the shortage of trained staff and do not yet reach the majority of farmers.[48]

84. Another weak spot in the educational programmes of developing countries is an inadequate recognition of the need to devise effective programmes of adult education. Illiteracy percentages have been reduced, notably in Asia and Latin America (table 13), although there may not have been any decrease in absolute terms. Adult education programmes deserve special emphasis because investment in this field may pay off in a very short period, in contrast with education of children and young people, which yields results only after a relatively long period of time. Such programmes tend to have the greatest impact if the workers selected are those in a position to put their new skills and knowledge to work immediately.

[44] ECAFE, *op. cit.*, p. 82.

[45] UNESCO, *Educational Developments in Latin America 1956-1965* (Minedecal/6).

[46] According to the regional educational plans formulated in co-operation with UNESCO, the targets of educational development for the third level provided for the enrolment ratio to be raised by 1965 to 0.35 per cent in Africa, 3.4 per cent in Latin America and 3.4 per cent in Asia. See *UNESCO's Contribution to the Promotion of the Aims and Objectives of the United Nations Development Decade*: report by the Director-General, 14C/10, Paris, 1966, annex II, tables 1 to 3.

[47] Economic Commission for Africa, "Trained manpower requirements for accelerated economic growth in the East African sub-region" (E/CN.14/LU/ECOP/9) (1965).

[48] FAO, *op. cit.* (1965), p. 9.

Chapter VI

The planning process

85. A development plan or programme involves the conscious application of interrelated policy instruments so as to influence or direct the course of economic development. Planning necessitates an explicit analysis and evaluation of various alternatives within a comprehensive and consistent framework. It thereby facilitates and rationalizes the process of decision-making by both public authorities and private enterprise.

86. The principle of planning has gained widespread acceptance in the developing countries. Most developing countries now have plans of development, although in some of them the planning process is much more advanced than in others. The techniques of macro-economic planning are fairly well known in many developing countries, and have been widely applied in the drawing up of national plans.

87. The preparation of a plan is, however, only the beginning of the planning process and the effectiveness of planning depends greatly on the mechanism for plan implementation. In this respect, performance varies a great deal. Sometimes political instability or administrative obstacles greatly affect the implementation of plans. Often, inadequate data and lack of technical experience result in the establishment of unrealistic targets which fail to materialize. Particular difficulty is often experienced in working out the sectoral requirements of a global plan and in securing adequate performance at the sectoral level.[49]

88. While the failure to realize plan targets in many developing countries has been disappointing, progress in this field should not be judged exclusively by the results achieved so far. Sometimes, success or failure in the realization of plan targets may be affected by factors quite beyond the control of a Government. In appraising the effectiveness of planning, the real issue is whether, through the adoption of a plan, the management of government policies has been improved. If a plan contributes to the more effective mobilization and utilization of resources for the achievement of national economic and social objectives, it serves its purpose even although the specified targets may not be fully realized. Judged from this standpoint, the planning process in the developing countries is serving a useful purpose and is undergoing improvement over time. In the words of a recent OECD report: "Of notable importance is the improvement in the planning process. First attempts in

[49] Problems of plan implementation in developing countries are discussed in considerable detail in United Nations, *World Economic Survey, 1966, part I* (United Nations publication, Sales No.: E.67.II.C.1).

this direction often set unrealistic targets, required administrative direction far beyond that which was available, failed to take into account the related manpower requirements and were unrelated to their subsequent implementation. The assistance which sensible planning can give to policy makers, to international institutions and to the bilateral donors has now become clear and the next generation of plans is proving to be much more useful ".[50]

Chapter VII

Evaluation of plans and performance

89. It is generally agreed that, while developing countries must bear the primary responsibility for their development, external assistance also has an important role to play both by adding to the resources at the disposal of developing countries and by helping them to mobilize and make more effective use of their own resources.

90. It is not unreasonable for donor countries to seek to ensure that their aid is put to effective use. This would require that an objective analysis of development plans and economic performance be made so as to establish that aid is really being used to promote development. Developing countries, for their part, have a right to insist that such an evaluation should be based on technical and economic criteria and that political factors should be set aside.

91. A country's economic performance has many aspects and is influenced by many factors, some of which may be beyond government control. Thus it is not possible to set up meaningful performance norms without a detailed analysis of the structural characteristics, potentialities and constraints—economic, social and cultural—which condition the pace of development of each developing country. Obviously, no single criterion would do justice to the great variety of experience to be found within the developing world. Thus it would appear that an impartial expert evaluation of plans and performance on a continuing periodic basis would help greatly in evolving an effective international development policy. It would strengthen the hands of those who would like aid to be divorced from objectives other than that of promoting economic development. It would also provide an assurance to donor countries that their aid is being put to good use without requiring them to set up evaluation machinery of their own, a task for which only a few major donor countries have the resources or the inclination.

92. If the principle involved in the above proposal were accepted, appropriate institutional arrangements could be worked out.

[50] OECD, *1966 Review, op. cit.*, p. 24.

ANNEX

TABLE 1

Developing countries: average annual growth rates of real gross domestic product[a], 1950-1960 and 1960-1966

(Percentage)

Country[b]	*1950-60*	*1960-66*	*Country*[b]	*1950-60*	*1960-66*
China (Taiwan)	7.9	9.7	Turkey	6.3	4.9
Greece	5.9	9.7	Philippines	4.5 [g]	4.8
Syria [c]	3.4	9.2 [d]	Honduras	3.5	4.8
Israel	11.1	8.4	Jamaica	7.7 [e]	4.8
Jordan	8.7 [e]	8.3	Colombia	4.6	4.7
Panama	4.5	8.0	Chile	3.6	4.6
Nicaragua	5.3	7.8	Kenya	3.5 [i]	4.5
Korea, Republic of	5.2	7.5	Ecuador	4.9	4.3
Thailand	6.4	7.2	Brazil	5.8	4.2
Trinidad and Tobago	8.5	6.6	Southern Rhodesia	6.4 [g]	4.0 [d]
Peru	5.2	6.6	Tanzania	...	3.7
Guatemala	3.8	6.5	Uganda	4.2 [i]	3.5
Iraq [f]	4.5 [g]	6.4	India [c]	3.7	3.2
Mexico	6.1	6.2	Argentina	3.1	2.6
Malaysia	4.1 [g]	6.1	Morocco	1.1 [h]	2.5
Zambia	6.3 [g]	6.0	Ceylon	3.1	2.3
United Arab Republic	5.9 [h]	5.9 [d]	Indonesia	5.0	2.0 [d]
Iran	7.3 [i]	5.9	Burma	5.4	2.0
Pakistan [f]	2.7	5.3	Ghana	5.7	1.9
Venezuela	7.6	5.2	Dominican Republic	5.7	1.7
Bolivia	0.2	5.1	Malawi	4.0 [i]	1.0 [j]
Nigeria	4.1	5.1	Uruguay	0.0 [g]	0.4
Tunisia	3.7	4.9			

Source: United Nations, *Statistical Yearbook, 1966* (United Nations publication, Sales No.: 67.XVII.1), *Monthly Bulletin of Statistics* and national sources.

[a] Computed as average annual compound rates of growth of gross domestic product at constant market prices.

[b] In descending order of the rate of growth during 1960-1966.

[c] Net domestic product at constant factor cost.

[d] 1960-1965.

[e] 1953-1960.

[f] At constant factor cost.

[g] 1955-1960.

[h] 1956-1960.

[i] 1954-1960.

[j] 1960-1963.

TABLE 2

Gross domestic capital formation in developing countries: average 1963-1965

(Percentage of gross domestic product)

Under 10 per cent	*10 to 15 per cent*	*15 to 20 per cent*	*20 per cent and above*
Vietnam, Republic of	Chile	Argentina	China (Taiwan)
	Congo, Democratic Republic of [a]	Barbados [a]	Greece
	Dominican Republic	Bolivia	Israel
	Ecuador	Brazil	Peru
	El Salvador	Burma [a]	Thailand
	Ethiopia [b]	Cambodia [c]	Trinidad and Tobago
	Guatemala	Ceylon	Tunisia
	Iraq [a]	Colombia	Venezuela
	Malawi [c]	Costa Rica	
	Morocco	Ghana	
	Nigeria [b]	Guyana [a]	
	Philippines	Honduras	
	Sierra Leone [d]	India	
	Southern Rhodesia	Iran	
	Tanzania	Jamaica	
	Uruguay	Jordan	
		Malaysia	
		Mauritius	
		Mexico	
		Nicaragua	
		Pakistan	
		Panama	
		Paraguay	
		Korea, Republic of	
		Sudan [a]	
		Togo [d]	
		Turkey	
		United Arab Republic [b]	
		Zambia	

Source: United Nations, *Monthly Bulletin of Statistics, Yearbook of National Accounts Statistics, 1965* (United Nations publication, Sales No.: 66.XVII.2), and national sources.

[a] 1962-1964.

[b] 1961-1963.

[c] 1962-1963.

[d] 1963-1964.

TABLE 3

Developing countries: average annual growth rates of real gross domestic investment [a] 1950-1965

(Percentage)

Under 5 per cent	*5 to 7.5 per cent*	*7.5 to 10 per cent*	*10 per cent and above*
Argentina	Barbados [b]	Israel	China (Taiwan)
Bolivia	Brazil	Jamaica	Ghana [c]
Burma [b]	Chile	Pakistan	Greece
Ceylon	Costa Rica	Panama	Jordan [f]
Colombia	El Salvador	Korea, Republic of	Malaysia [g]
Dominican Republic	Guatemala	Trinidad and Tobago [b]	Nigeria [c]
Ecuador	Guyana [b]	Turkey	Thailand
Honduras	India [c]	United Arab Republic [e]	Tunisia [h]
Peru	Iran [d]		
Uruguay	Mauritius [b]		
Venezuela	Mexico		
	Nicaragua		
	Paraguay		
	Philippines		

Source: United Nations, *Yearbook of National Accounts Statistics* and national sources.

[a] Calculated by fitting a time trend to data on real gross investment (at 1960 market prices).

[b] 1953-1964.

[c] 1950-1963.

[d] 1954-1964.

[e] 1957-1963.

[f] 1954-1963.

[g] 1955-1965.

[h] 1960-1965.

TABLE 4

Gross domestic savings[a] in developing countries: average 1963-1965

(Percentage of gross domestic product)

Under 10 per cent	*10 to 15 per cent*	*15 to 20 per cent*	*20 per cent and above*
Barbados[b]	Bolivia	Brazil	Argentina
Ethiopia[c]	Cambodia[d]	Burma[b]	Guyana[b]
Jordan	Ceylon	China (Taiwan)	Iran
Malawi[d]	Chile	Colombia	Iraq[b]
Korea, Republic of	Congo, Democratic Republic of[b]	Greece	Malaysia
Vietnam, Republic of	Costa Rica	Jamaica	Mauritius
Sierra Leone[e]	Dominican Republic	Mexico	Peru
Togo[e]	Ecuador	Nicaragua	Southern Rhodesia
	El Salvador	Panama	Thailand
	Ghana	Philippines	Trinidad and Tobago[b]
	Guatemala	Tanzania	Venezuela
	Honduras		Zambia
	India		
	Israel		
	Morocco		
	Nigeria[c]		
	Pakistan		
	Paraguay		
	Sudan[b]		
	Tunisia		
	Turkey		
	United Arab Republic[c]		
	Uruguay		

Source: United Nations, *Monthly Bulletin of Statistics, Yearbook of National Accounts Statistics* and national sources.

[a] Calculated as gross domestic capital formation minus (plus) the balance of payments deficit (surplus) on goods and services account, excluding factor income payments.

[b] 1962-1964.

[c] 1961-1963.

[d] 1962-1963.

[e] 1963-1964.

TABLE 5

Developing countries: marginal rates of savings in relation to real gross domestic product[a], 1950-1965

(Percentage)

Under 10 per cent	*10 to 15 per cent*	*15 to 20 per cent*	*20 per cent and above*
Barbados[b]	Chile	Brazil	Argentina
Bolivia	Costa Rica	Colombia	China (Taiwan)
Ceylon	Ecuador	El Salvador	Greece
Dominican Republic	Guatemala	Ghana[c]	India[c]
Honduras	Israel	Mexico	Iran[d]
Nigeria[c]	Panama	Nicaragua	Iraq[b]
Korea, Republic of	Turkey	Pakistan	Jamaica
	Uruguay	Peru	Malaysia[e]
		Sudan[b]	Philippines
		Trinidad and Tobago[b]	Thailand
			United Arab Republic[f]
			Venezuela
			Zambia

Source: United Nations, *Monthly Bulletin of Statistics, Yearbook of National Accounts Statistics* and national sources.

[a] Percentage of incremental real gross domestic product (at 1960 market prices) saved; calculated by fitting a linear equation of the form $y = a + bx$. Results not statistically significant were omitted.

[b] 1953-1964.

[c] 1950-1963.

[d] 1954-1964.

[e] 1955-1965.

[f] 1957-1963.

TABLE 6

Developing countries: government tax revenue as a proportion of gross domestic product, average 1955-1957 and 1963-1965

(Percentage)

Country [a]	*1955-1957*	*1963-1965*	*Country* [a]	*1955-1957*	*1963-1965*
Uruguay	26	28 [b]	Southern Rhodesia	14	15
Israel	23	26 [c]	Burma	15	14 [c]
Brazil	19	22 [b]	China (Taiwan)	17	14
Chile	18	22	Panama	12	14
Greece	19	22	Guyana	18	13 [b]
Tunisia	22 [d]	22	Bolivia	12	12
Zambia	21	21	Philippines	10	12
Argentina	19	19 [d]	Ghana	12	12
Malaysia	18	19 [b]	Trinidad and Tobago	13	12 [b]
Mauritius	15	18	Nigeria	9	11 [c]
Ecuador	14	17	India	9	11 [c]
Jamaica	12	16	Colombia	11	10 [c]
Peru	14	16	Jordan	12	10 [c]
Barbados	18	16 [b]	Honduras	7	10 [c]
Venezuela	17 [d]	16	Tanzania	10 [d]	10
Costa Rica	14	15 [b]	Korea, Republic of	8	9
			Guatemala	10	8 [b]

Source: United Nations, *Yearbook of National Accounts Statistics 1965* (United Nations publication, Sales No.: 66.XVII.2), *Statistical Bulletin for Latin America*, vol. 3, No. 1 (United Nations publication, Sales No.: 66.II.G.6), and national sources.

[a] In descending order of percentage ratios in 1963-1965.
[b] 1962-1964.
[c] 1961-1963.
[d] 1960-1962.

TABLE 7

Developing countries: revenue from indirect taxes as a proportion of total government tax revenue, average 1955-1957 and 1963-1965

(Percentage)

Country [a]	*1955-1957*	*1963-1965*	*Country* [a]	*1955-1957*	*1963-1965*
Zambia	16	23 [b]	Bolivia	60 [f]	66
Uruguay	52	42 [b]	Peru	51	66 [b]
Chile	44	45	Costa Rica	70	68
Venezuela	54 [c]	46	Malaysia	77	69 [b]
Southern Rhodesia	46	47	Mauritius	57	69
Trinidad and Tobago	54	50 [c]	Barbados	63	70 [b]
Guyana	65	54 [b]	Burma	71	70 [d]
Panama	63	55	Philippines	74	71
Argentina	52	57 [b]	Brazil	67	72 [b]
Colombia	61	57 [d]	India	70	73 [d]
Ecuador	72	57	Guatemala	76	77 [b]
Tanzania	55 [e]	59 [b]	Nigeria	57	78 [d]
Greece	60	61	Ghana	86	79 [b]
Jamaica	63	62	Jordan	84	83 [d]
Israel	61	63	Honduras	84	86 [d]
Korea, Republic of	71	63	China (Taiwan)	85	87

Source: United Nations, *Yearbook of National Accounts Statistics* and national sources.

[a] In ascending order of the share of indirect taxes in total tax revenue during 1963-1965.
[b] 1962-1964.
[c] 1960-1962.
[d] 1961-1963.
[e] 1960-1961.
[f] 1958-1960.

TABLE 8

Developing countries: income elasticity[a] of government tax revenue, total current revenue and current expenditure

Country[b]	*Period*	*Tax revenue elasticity*	*Current revenue elasticity*	*Current expenditure elasticity*
India	1953-1963	1.8	1.7	1.7
Nigeria	1955-1962	1.4	1.8	1.9
Philippines	1950-1965	1.4	1.4	1.3
Costa Rica	1950-1964	1.3	1.2	1.7
Ecuador	1950-1965	1.3	1.3	1.2
Israel	1950-1963	1.3	1.3	1.1
Malaysia	1955-1964	1.3	1.4	1.2
Panama	1951-1965	1.3	1.0	0.8
Burma	1950-1963	1.2	1.3	1.6
Honduras	1950-1963	1.2	1.2	1.9
Greece	1955-1964	1.2	1.2	1.1
Jamaica	1950-1965	1.2	1.2	1.2
Korea, Republic of	1953-1965	1.2	1.2	1.1
Peru	1950-1965	1.2	1.2	1.3
Southern Rhodesia	1955-1964	1.2	1.2	1.5
Zambia	1956-1965	1.2	1.1	1.3
Bolivia	1958-1965	1.1	1.1	1.0
Brazil	1954-1964	1.1	1.0	1.1
Chile	1952-1965	1.1	1.1	1.1
Ghana	1955-1964	1.1	0.9	1.6
Tunisia	1960-1965	1.1	1.2	1.0
China (Taiwan)	1951-1965	1.0	1.0	1.0
Uruguay	1955-1964	1.0	1.1	1.1
Colombia	1953-1963	0.9	0.9	1.1
Tanzania	1960-1964	0.9	0.7	1.4
Trinidad and Tobago	1953-1962	0.9	0.9	0.7
Venezuela	1960-1965	0.9	1.0	0.8
Guatemala	1955-1964	0.5	0.4	1.2

Source: United Nations, *Yearbook of National Accounts Statistics* and national sources.

[a] Estimates of elasticities have been derived by fitting a log-linear function to the data with gross domestic product as the independent variable. Results that were not statistically significant were omitted.

[b] In descending order of the elasticity of tax revenue.

TABLE 9

Indices of total and per capita agricultural production in the developing regions in selected years

(Indices, average 1952/53 - 1956/57 = 100)

Period	*Latin America*	*Far East*[a]	*Near East*[b]	*Africa*[c]	*All developing regions*
Total production					
1954/55	100	100	97	101	100
1959/60	122	116	121	114	118
1964/65	135	133	139	132	134
1965/66	138	131	140	130	134
Production per capita					
1954/55	100	100	97	101	100
1959/60	107	105	108	101	106
1964/65	103	107	108	104	107
1965/66	102	103	106	100	104

Source: FAO, *The State of Food and Agriculture, 1966*, table II.2, pp. 16 and 17.

[a] Including Japan, where the increase was larger than the average for the region between 1954/55 and 1959/60, and somewhat lower than the average for the region after 1959/60.

[b] Including Afghanistan, Cyprus, Iran, Iraq, Israel, Jordan, Libya, Sudan, Syria, Turkey and United Arab Republic.

[c] Excluding Libya, Sudan and United Arab Republic, including South Africa. The increase in South Africa was larger than the average for the region throughout the period.

TABLE 10

Average annual change in agricultural production and population in developing countries 1952/1953-1954/1955 to 1962/1963-1964/1965

(Percentage)

	Rate of increase in Production	Rate of increase in Population
Countries in which production increased		
4 per cent or more		
Israel	9.9	3.9
Mexico	6.3	3.1
Guatemala	5.8	3.1
Thailand	5.2	3.0
Venezuela	5.1	3.5
Yugoslavia	5.1	1.1
Syria	4.7	3.1
China (Taiwan)	4.3	3.4
Malaysia: Malaya	4.2	3.1
Brazil	4.0	3.0
3-3.9 per cent		
United Arab Republic	3.7	2.5
Panama	3.4	2.8
Iran	3.3	2.5
Korea, Republic of	3.3	2.6
Philippines	3.2	3.2
Ceylon	3.1	2.6
Ethiopia	3.1	1.7
Honduras	3.1	3.1
2-2.9 per cent		
India	2.7	2.2
Burma	2.5	2.2
Colombia	2.4	2.8
Peru	2.4	2.6
Chile	2.2	2.6
Pakistan	2.2	2.4
0.1-1.9 per cent		
Argentina	1.7	1.7
Morocco	1.6	2.8
Tunisia	1.1	1.8
Indonesia	1.0	2.2
Cuba	0.7	2.2
Iraq	0.6	2.8
Countries in which production declined		
Algeria	−0.4	1.8
Uruguay	−0.4	1.5

Source: FAO, *The State of Food and Agriculture, 1966,* table II-3, p. 19.

TABLE 11

Estimated average import component of agricultural investment projects financed by IBRD[a]

(Percentage)

Type	Number of projects	Total cost of projects ($ million)	Import content as a percentage of total cost
Irrigation	26	923	35
Multipurpose (irrigation, power, flood control, navigation etc.)	3	221	32
Agricultural credit	11	218	42
Livestock	6	150	38
Land settlement	3	74	24
Food-grain storage	1	39	62
Fisheries	1	9	83
TOTAL	51	1,634	36

Sources: IBRD.

[a] Includes projects still in operation in mid-1966, which roughly corresponds to loans granted within the last decade.

TABLE 12

School enrolment indices by level and region, 1958-1963 and 1965-1970

	Enrolment trends		*Enrolment objectives*	
	1958	*1963*	*1965*	*1970*
Africa				
Third level	100	238	100	174
Second level	100	195	100	185
First level	100	151	100	133
Asia				
Third level	100	152	100	150
Second level	100	162	100	159
First level	100	138	100	135
Latin America				
Third level	100	155	100	138
Second level	100	170	100	184
First level	100	134	100	125

Source: UNESCO, *UNESCO's Contribution to the Promotion of the Aims and Objectives of the United Nations Development Decade:* Report by the Director-General, 14C/10, Paris, 1966, annex II, p. 38.

TABLE 13

Illiteracy among adults [a] in developing countries

(Percentage of total adult population)

	1950	*1960*	*1965*
Africa	86.8	84.3	82.9
Asia	77.9	66.8	60.4
Latin America	42.8	34.3	29.0
Total, developing countries	73.5	63.9	58.3

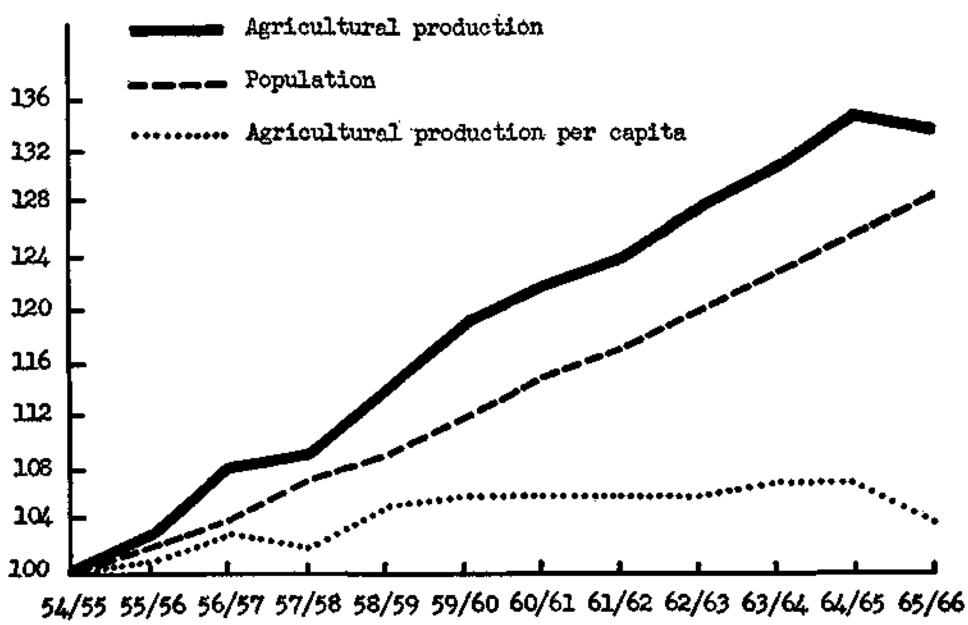
Source: UNESCO, *UNESCO's Contribution to the Promotion of the Aims and Objectives of the United Nations Development Decade:* Report by the Director General, 14C/10, Paris, 1966.

[a] Adults are defined as persons of the age of 15 years and above.

CHART

Trends in agricultural production and population in developing countries

(Indices 1954/55 = 100)



Source: FAO.

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Problems of economic management at the governmental level in developing countries and the implementation of central decisions: study prepared by the Centre for Afro-Asian Research of the Hungarian Academy of Sciences

[Original text: English]
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CONTENTS

Chapter I

The concept of execution

1. In the initial phase after achieving independence, practically every Government has striven to develop its own long-range economic programme and for this reason economic advisers have been kept busy in the first place with problems of planning. Scientific thinking has also proceeded in this direction because it has realized that the most immediate task is to determine the general lines of economic activity.

2. The importance of good planning remains undiminished, though there seems to have been a shift in the professional interests of economists; problems of comprehensive planning are gradually giving way to specific development plans of individual sectors of the economy and there is a new emphasis on execution as one of the basic factors in economic progress. What is the background to this shift in interest? It will be found in the demands imposed by practice.

3. The role of execution can be studied in connexion with the following four types of decisions:

(a) Correct and practical decisions (this does not exclude the possibility of their non-fulfilment);

(b) Wrong but practical decisions (e.g. the one-sided over-development of a branch or sector);

(c) Wrong and impractical decisions;

(d) Decisions that appear right in themselves and are wrong only because they cannot be carried out (e.g. exaggerated targets for school registration).

4. A study of the execution and a better understanding of the problems involved enables one to avoid the errors of types *(c)* and *(d)*.

5. Errors due to mechanical imitation of the practice of other countries generally belong to type *(d)*, i.e. they are " right " but impractical.

6. Execution of the plan lies largely in the hands of developing countries themselves and self-help must play the key role. Here there is little scope for external aid to replace domestic resources. Lack of domestic capital can in principle be remedied by foreign capital ; and the experts to prepare major decisions can somehow be obtained from abroad, but the thousands and tens of thousands of cadres who do most of the actual work of carrying out these decisions can only come from domestic resources, not only because there is simply no place to import them from, but also because their work demands local knowledge which people brought up in other societies cannot possess.

7. The stress laid in this study on self-help does not mean that we underestimate aid from rich countries. On the contrary, we think that neither the amount nor the efficacy of such aid is sufficient. And all this applies to our field, too ; increased aid is indispensable to promote the capacity to implement. In other words, developing countries need more experts, in key executive posts and more opportunities for training of this kind. This type of aid is a *sine qua non* for the effective qualitative improvement of implementation in the near future.

Correct analysis of plan execution

8. It would be a grave mistake to regard an analysis of statistical reports on plan fulfilment as a study of the execution of the plan. The fact is that the former gives information not on the successful or unsuccessful character of the work of execution, but on final results deriving from the correctness or incorrectness of the plan itself, from unforeseen factors (extreme weather, unexpected changes in the world market, etc.) and from the extent of foreign aid just as much as from the standard of execution. In order to discover the mistakes in this phase, we have to examine implementation itself. A full explanation of plan fulfilment can thus be derived only from a complex analysis of the results and the processes leading to these achievements.

9. What does analysis of implementation include ? An analysis of the methods and efficiency of

(a) Incentives and direction ;

(b) Training and selection of personnel ;

(c) Organizational forms, jurisdiction ;

(d) Operational patterns and arrangements ;

(e) System of control.

Role of government in plan fulfilment

10. In our view, the government is responsible for plan fulfilment though we know that the role of the government is far from identical in every developing country.

11. The present study assumes that there is a resolute and strong government which works consistently for social and economic progress ; it presupposes a system led by progressive-minded statesmen who wish to steer their homeland into the twentieth century, who aim to establish just social conditions and are able to implement the necessary social reforms, which are preconditions of a modern society and economy. Such governments agree that, in the first place, they are responsible for the achievement of economic and social development. This comprehensive interpretation of responsibility and duty enables us to deal with problems arising at the most varied economic and social levels. Wherever the critical points of implementation appear, the government leadership is, in our opinion, obliged to intervene.

Social and political aspects of plan implementation

12. Execution of the plan can never be restricted simply to an appropriate sequence of economic measures. The social and political aspects are already evident in the drafting of the plan, and if the plan decisions are political acts, their execution is also a succession of political acts, in fact often even more so. A long period of implementation and the inevitable concomitant difficulties provide opportunities for groups whose views or interests (or supposed interests) are contrary to the plan targets, to slow down or even to hinder plan fulfilment.

13. At the level of government leadership, the political aspects and applications become very apparent. Representatives of the different groups of interests usually sit in the various organs and offices, and their acts deliberately and sometimes subconsciously reflect their views.

14. Thus, the phase of execution can by no means be regarded as free of politics and, although our study does not delve into the political implications, we must not forget that they exist.

Chapter II

Public administration at the government level for the execution of the plan

15. In order to achieve the social and economic goals of development in the developing countries, it is a most serious mistake to insist on copying either Western or socialist administrative practice. The new situation requires new organizations and functions ; this is what governments in the developing countries must recognize, and their European and United States advisers must understand this.

Need for strong centralised administrations

16. As Professor Bruno Tohngodo puts it so aptly, public administration must become " *l'administration du développement* ".[1]

[1] Bruno Tohngodo : " Défaillances et insuffisances de l'Administration Publique des Etats d'Afrique Noire et à Madagascar ", *Développement et civilisation,* 1967, vol. III, No. 29, p. 13.

17. This type of function determines the organizational structure of the administrative network. The answer to the question of centralized versus decentralized organization is to be found in the main task of administration, which is the promotion of development. Hence, obviously the stress should be where this responsibility is the most decisively represented and this is at the administrative level closest to the political factors of State leadership. Consequently, in our opinion, a strongly centralized administration is best adapted to execute the tasks facing developing countries.

18. In countries divided into larger provinces or states, the control of planning and execution is usually distributed among the federal and provincial (or state) centres. India and Nigeria are characteristic examples of this latter arrangement.

19. Centralization should not be regarded as an end in itself: The feelings of the people and existing economic and geographical conditions must be duly considered. The substance of our stand is not an organizational scheme but the need for certain requirements to be met within the administrative apparatus. Authority should be distributed in such a way that the centre (or centres) representing advanced policies should be able to enforce its instructions down to the lowest levels.

20. The efforts to achieve a unified direction of economic policy or the necessities that force the Government to proceed in this direction have in every developing country brought the administrative centre of economic policy into being in some form or other. The various administrative organizations which constitute this centre exercise considerable influence on all decisions on economic development despite the fact that the administration does not make the formal decisions on economic development anywhere.

Role of the planning office

21. Within the centre of economic administration the planning office[2] holds a special position. There are three main reasons why, during the period of plan implementation, there is a need for permanent contact between the Government and the planning office.

(a) Plans never materialize exactly according to the original drafts, and consequently a re-evaluation of the changing situation is frequently needed;

(b) The views and judgements of those exercising political power may change;

(c) The permanent participation of the leaders of the planning office in everyday government work is one of the best guarantees that the long-term economic targets of the country will be achieved.

22. It follows from this situation that whether it is formally responsible for execution of the plans or not, the planning office must carefully follow all measures of economic policy and its advice must carry great weight when the decisions are taken. The more weight long-range planning carries in a given country, the more the planners influence the bodies that make the supreme decisions and, organizationally, the more independent the planning office the greater is its influence on economic life as a whole.

23. Beyond a certain limit the influence of the planning organization may have its disadvantages, too. It may retard adaptation to the actual situation, make a fetish of targets which experience has proved to be bad, and prevent sober, short-range decisions.

Problem of shortage of administrative manpower

24. A society which is short of cadres naturally feels the disadvantages of this shortage in public administration, too. There is no need to elaborate unduly on the importance of this, and below we shall emphasize only three aspects directly connected with plan fulfilment, namely, the composition and level of the staff, the training and further education of cadres, and outside assistance.

The composition and level of the staff

25. The composition and the qualifications of the personnel should be determined by tasks of economic development, except that the shortage of personnel often makes selection academic.

Training and further education of cadres

26. A significant method which immediately comes to mind is further education, including advanced training on the spot, various forms of full-day courses, courses taking up a few hours in the week and individual study.

27. Courses offered by institutes of public administration impart this type of knowledge, equipping students with the basic skills of general and specialized administration.

28. All this has to be made available, as far as possible, with advanced methods of adult education that require the least expense and the smallest number of teachers.

29. Experience in Hungary provides convincing evidence that it is not enough to make graduation from school obligatory. A kind of spirit has to be developed in which superiors and colleagues alike urge, assist and encourage further study.[3]

Outside assistance

30. In overcoming the shortage of high-level administrative manpower, the possibilities of outside assistance are limited. Even the foreigners who work in industrial

[2] For the sake of simplicity, the name planning office is used regardless of the different nomenclatures applied to this organ in different countries (planning committee secretariat, planning unit of the Ministry of Economic Development, etc.).

[3] Correspondence students at the universities are given time off (paid) for their Saturday lectures, and twenty-four days of special "study holidays" a year (also paid).

or business companies are an irritant to national pride and sovereignty, and this attitude is even stronger in the case of public administrative officials who are supposed to represent the nation and the State.

31. With the establishment of institutes of administration, international organizations and the advanced countries have made an excellent start in providing assistance. It is in education in administration that the international organs and the countries willing to help can give the most extensive assistance. This is an excellent and very efficient start but, as compared to the need, it is far from adequate.

32. Finally, there is an additional important field for external assistance, namely, research in administration — the evaluation and generalization of the administrative experience of developing countries. Analysing the specific administrative functions in the initial phases of economic and social development and identifying the organizational patterns which have proved effective are a valuable way of helping to improve the operation of public administration.

Chapter III

Taxation and financial policy as a means of implementing plans and mobilizing economic resources

Role of taxation

33. Taxation is one of the ways of mobilizing domestic resources in monetary terms.

34. One of the most important sources of tax revenue of the developing countries is export customs duties, but this source is highly unreliable. Efforts should therefore be made to decrease the proportion of export duties within the State revenues. Indirect taxation has definite advantages in the developing countries.

35. The possibility of introducing an efficient system of direct taxation is limited, whereas, under the indirect tax system, taxes are assessed and paid by firms ; thus, the existing economic organization performs the duties of the tax collector's office. From the viewpoint of short-range policy it is expedient to merge taxes and prices (this in fact, happens in the case of manufacturers' excise taxes) but, in the long run and for the sake of establishing a democratic nation, it is desirable to make proper preparations for introducing an income tax.

36. As to the corporation income tax, besides the taxation of profits to a larger or smaller extent, it might be expedient to impose taxes on one or other of the cost elements and to choose those which can be fairly easily assessed by means of book-keeping (even outside the firm). For the purpose of skimming off profits not only taxation but many methods and forms of price and tariff policy can be applied as alternatives to influence the distribution of incomes.

37. Payments made into the State treasury by State-owned enterprises, or those in which the State has an interest, are a highly favoured source of capital formation.

38. A good example is provided by the socialist countries where the overwhelming bulk of budgetary revenues comes from the payments made by State or co-operative enterprises (this amounts in Hungary to 80 per cent). The major part of the payments consists of turnover taxes and the smaller part of profits paid in by State-owned enterprises.

39. Privately owned capital must also be increasingly mobilized for investment purposes with the help of State measures directed to this end.

40. One way of mobilizing private capital may be by introducing measures to transform capital by changing the existing capital structure. The unsatisfactory composition of capital is a well-known feature of developing countries ; trading capital predominates and, at the same time, funds for the financing of agricultural and industrial investments are in short supply. Since the surplus of trading capital and the shortage of industrial and agricultural capital do not cancel each other out spontaneously (because, among other things, of the profitability and safety of capital and the backwardness of the banking system), it is necessary to take purposeful measures to achieve the transformation of capital.

41. In several developing countries, usurious loans and the buying-up of agricultural products go hand in hand. Calculations show that both the magnitude and the economic effect of usurious loans are sufficiently large to be taken into account when taking stock of economic resources.

42. Various co-ordinated measures are needed to channel usurious capital towards development. In the first place, the supply of credit on "normal" terms should be expanded either by establishing loan banks (mainly credit societies) or as part of agricultural marketing and supplying co-operatives. In practice this does not simply mean the expansion of credits, but the replacement of trading capital and usurious loans by these credits.

43. At the outset the State might pay higher rates of interest than normal (though far lower ones as compared to the usurious interest rate) for long-term bank deposits, in order to siphon off hoarded capital. If, at the same time, development credits are granted at a low rate of interest, usurious loans will be ousted by new sources of credit which have arisen out of the former usurious capital itself.

44. Naturally, collecting deposits with a high interest rate and offering credits at a low one means a negative interest gap which must be bridged by subvention. But the high interest rate paid for deposits may attract a considerable amount of hoarded capital. At any rate, less financial resources are needed to close such a negative interest gap than to replace the total amount of hoarded capital by other sources, for instance, by credits from abroad.

45. Such difficult financial-political manoeuvres have to be carefully co-ordinated with the corresponding real processes of economic activity. A well conceived expansion of production in line with the extension of credits (e.g. an agricultural surplus created through credits) may offset an inflationary trend.

New credit sector

46. These new and complex financial targets require a new credit sector. In addition to State finance and the private money market, a third sector—sponsored and aided by the State—is also needed, whose units are owned by the people and will organize the collective financial self-help of the population at the local level. Credit societies and farmers' co-operatives could be suitable bases for this third sector. Experience proves that co-operatives, if they are adequately supported, can be important factors of domestic capital formation.

47. It should also be mentioned that the hoarded "traditional" capital to be mobilized sometimes takes the form of material assets (e.g. cattle that are considered as "treasure") which could be introduced in its original form into the active economy.

48. Domestic capital formation by means of a prices policy can be achieved, first and foremost, in agriculture. There are, however, some structural preconditions for this. First of all, state-controlled organization should carry out the purchase of the produce and thereby exclude intermediates who exploit the peasants by charging usurious rates of interest. It is obvious that the Government can only prescribe or influence the purchase prices if it can rely on organizations of its own.

49. Finally, it should be mentioned that for accumulation, agricultural produce can be delivered partly in kind. In Senegal, for instance, farmers are allowed to pay off credits in kind.

Chapter IV

Some questions bearing on the implementation of industrialization plans

50. It is of the utmost importance that, with regard to large-scale investments, all the alternatives should be taken into consideration and inputs and outputs scrutinized realistically. It is advisable to refer to more than one expert's opinion, in order to check the feasibility and soundness of the project, and to include among the experts, persons who have no vested interest in the implementation of the project.

51. When the costing of the probable imput is being analysed, authorities may find it useful to compare the investment estimates with the actual figures of similar projects.

52. Experience shows that, generally speaking, it is not the building and installation costs of the plant itself which are underestimated but those of the investment in the complementary productive and non-productive workshops. This is particularly true of a project which has not been built in or near a town but in a previously uninhabited area where a population has to be settled in addition to the plant.

53. The difficulty of measuring the output is attributable to three main factors of uncertainty:

(a) The probable volume of production;

(b) Sales possibilities and prices;

(c) The cost level.

54. These three elements together determine the viability of the project, and the uncertainty of the three factors is the combined risk which has to be taken in connexion with the project.

55. The main cause of insufficient utilization of investment and, in general, of capital stock is the shortness of the working time (or more precisely the short period of time) during which the machinery is actually in operation. The number of working days of even fully employed urban workers is very low and does not exceed 200-250 days annually. Work done in only one shift is another feature in under-developed countries, as a result of which the utilization of the machinery does not exceed 20 per cent.

56. For the Government of a developing country sales possibilities and prices constitute the basis of the prospective profit, on the basis of which the rate of assessment and tax revenues can be calculated.

57. In order to circumvent the law, capitalist investors employ, sometimes even before the project has been set up and the credit granted, a group of lawyers and tax experts with whose help they arrange to evade the payment of local taxes after they have reaped a considerable part of the profits. The under-developed countries could protect themselves against these underhand practices by gathering information on the real sales possibilites and on prices and, if necessary, they themselves could transact the sale of the products.

Small-scale industry

58. From the aspect of economic growth and technical advance, two specific fields of small-scale industry are particularly noteworthy: *(a)* micro-industry which uses modern tools and equipment in order to meet the requirements of up-to-date technical demand; and *(b)* the repair industry which, on a small scale, forms part of the iron, metal and machine industry.

Micro-industry

59. Micro-industry means mechanized production in small workshops where a few workmen operate machines and each workshop produces a special model (type). Their sphere of activity is practically unlimited and ranges from building materials, items of clothing, tools, electrical equipment and motor car parts to builders' hardware, nails, nuts, screws, farm implements, artisan hand tools, etc.

60. Micro-industry is a field where self-help can be applied as one of the means of solving problems on the spot. This is because it is decentralized and involves the careful use of capital in order to increase gradually the growth of technical development on a wide basis. The aid Nepal and Pakistan received from Sweden and Switzerland for the development of their small-scale industry shows that aid granted by small advanced countries can be a powerful stimulus in helping countries to develop in this region.

61. An intermediate organizational and guiding institution is needed between the micro-economic and macro-economic levels to provide the elements needed for the functioning of the small plant by means of purposeful measures, and to provide and strengthen backward and forward linkage.

62. Small-scale industrial activity can also be transformed into large-scale industry if the change is carried out on a co-operative basis.

The repair industry

63. The situation is somewhat different in the case of the repair shops and plants of the iron, metal and machine branch, i.e. the other large sector of the small-scale industry to be developed. It is absolutely indispensable to establish these shops and plants: from the macro-economic aspect it is essential that the continually increasing stock of machines and equipment, mainly imported, should be kept in good running order. However, at the outset and at the micro-economic level these plants will function profitably only in some branches.

64. It would help at the outset if the rural extension services operating in almost every developing country were to include repair shops with standardized equipment. Besides carrying out repair services, these workshops could spread technical knowledge and become in time the rural centres of technical education.

Hungarian agricultural machine and tractor stations

65. This may be a good place to mention the agricultural machine and tractor stations which were set up when the system of planned economy was introduced in Hungary. In addition to the services rendered in terms of mechanized farming, they repaired the machines of both co-operatives and individual farmers, disseminated technical knowledge and helped the young people in the villages to take up technical professions without having to move to another place.

Chapter V

The place and importance of agriculture in the implementation of development policy

66. The Government must play a decisive role in the " take-off " and acceleration of development: the formulation of the concept of agricultural development and its application to the plan of action; the establishment of social, political and economic relations that further development; and the launching of different plans.

67. In some parts of the developing countries, eliminating and transforming large estates, which hinder further development, is a matter of urgent necessity. Experience shows that the most expedient method is to modernize agriculture within the traditional framework, gradually introducing economic elements into the traditional communities and organizing them into co-operatives. Mexico has attained a remarkably quick rate of agricultural growth by taking advantage of land reform, increasing the number of small farms and retaining, and even increasing as far as possible, the traditional Indian communities (*ejidos*).

68. Even in countries where the economy is based entirely on extensive farming and further facilities for expansion are available, it would be more expedient to concentrate the energies of growth on intensive farming in the interest of more efficient development. In Ethiopia, for example, the extensively-raised cattle stock is too large, not only from the point of view of actual economic demand, but also from that of fodder reserves and water supply. A far smaller cattle stock than the present one would allow better grazing, feeding and watering of the animals, more effective veterinary care, improvement of the stock, etc. and this could mean better selling possibilities on external markets, i.e. the activating of latent resources. However, these aims cannot be realized under present conditions in view of the oversized and extensive system of animal husbandry. A shift from extensive to intensive breeding could be carried out in most of the developing countries. This could also be done in their crop sector too, with the foreseeable result that, with a decrease in the area of arable land, greater attention would be given to farming techniques and improved quality could create far better marketing conditions than exist at present. In line with the development of agriculture the proper direction and pattern of industrialization and of the distribution sector should be worked out. From the aspect of demand, the food and raw material processing industries are the partners of agriculture. In the majority of developing countries these industries have not developed at a satisfactory rate over the past two decades.

69. On the supply side, it is advisable to concentrate on improving the fertility of the soil. Integrated agronomical development (water supply, artificial fertilizers, seed improvement, higher standards of vocational training, development of distribution services) could contribute to an economically efficient increase in production in the decades to come without mechanization on a larger scale. Where there are yields of 10-20 quintals per hectare, manual sowing, fertilization and plant protection could also bring about a noticeable increase in the crop. In some of the countries of South-East Asia and in Egypt, too, traditional but labour-intensive farming techniques made it possible to reach very high crop yields. The main industrial partner of agriculture is the chemical industry producing artificial fertilizers, insecticides, plant protectors, etc.

70. The capacity of the distribution sector (transport, storage, trade) determines the further possibilities of development. In certain areas of several developing countries considerable quantities of agricultural surplus products pile up or are ruined simply because they cannot be marketed for lack of distribution capacity. The development of the distribution sector could bring large areas into the nation's active economic life and thus contribute to a quick increase in national income.

71. As regards the expansion of production, some prompt though temporary results can be achieved by eliminating certain economic and political obstacles. It is important that a type of economic and political environ-

ment should develop that prevents capital from being invested away from agriculture—except for public revenue purposes. Thus, building operations unjustified from the point of view of the national economy and speculative transactions in the dividing of land into parcels should not be tolerated. A very suitable organizational form for carrying out complex agricultural development programmes in a given area, including the preparatory processes of cultivation and settling, is the establishment of a firm by the Government expressly for this purpose. The fact that a firm manages the whole venture guarantees that economy will be observed. A case in point is the Société d'aménagement et d'exploitation du Delta in Senegal.

72. The establishment of State model farms is very important from the aspect of up-to-date farming techniques, organizational methods and speeding up diversification.

73. Owing to the widely different natural endowments and geographical features of the developing countries, national agricultural research work is very important because the economic and technical experience gained in countries which have a temperate climate cannot be applied to the developing countries.

74. Action by the State can partly take the form of the granting of credits. For the granting of agricultural credits, credit societies or other local organizations (e.g. producers' or buyers' co-operatives) can also be employed.

75. Moral and material incentives, e.g. bonuses awarded for outstanding production, might also yield considerable results. Bonuses for high yields or technical innovations in farming, in addition to the recognition of merit and to honorary titles, would effectively encourage farmers.

76. In order to speed up agricultural production, developed countries must also assist the agriculture of the developing countries to a greater extent and in a more efficient form than has been done so far. In the first phase of economic growth, assistance in the form of food is of decisive importance. Food aid should not only be a safety-valve in an emergency but directly further the growth of the economy and agriculture. Experience gained in Pakistan and Tunisia proves that food aid can contribute to capital formation.

77. Food aid is also welcome when, as a consequence of land reform or settlement programmes, a population is transferred from one region to another (as, for example, in Bolivia and Peru), a change-over from one structure to the other takes place and production lags or falls behind expectations.

78. Simultaneously with food aid, long-range agricultural development plans should be drawn up. After the technical assistance work has been done, the situation is ripe for changing over from food aid to assistance in terms of the means of production, chemicals, machinery, etc.

79. In several developing countries, better utilization of livestock, i.e. the development of the meat industry, is hindered owing to the lack of fodder. In such cases, aid in the form of long-range credits could be granted for the purpose of financing fodder imports, provided that the fodder is imported from another developing country. This kind of financial arrangement is a suitable means of developing agriculture, on the one hand, and expanding the markets of developing countries, on the other.

Chapter VI

Co-operatives as a means of implementing plans and mobilizing internal economic resources

80. Co-operatives have a special place among the institutions in developing countries.

81. The co-operative form of organization allows the small-scale and cottage industries to contribute to the economic growth of the country. Where artisans are in a position to establish, through co-operation, adequate relations with the wider field of industry and with the national economy in general, the course to be taken by the new forms of industry can be mapped out even in a decentralized economy. The plants processing agricultural products often represent the first step in industrialization.

82. The co-operative movement is an important instrument and organizational framework of agricultural policy. In the present state of the developing countries, agricultural reform is a prerequisite of economic growth. The consolidation and further development of the results achieved through the reform can best be attained by means of the agricultural co-operative movement. Co-operative farms have been set up in Kenya and co-operative rural settlements have been established in Tanzania with State support. In Senegal, the Société d'aménagement et d'exploitation du Delta applies similar methods of settlement on land brought under cultivation in the Delta region.

83. The co-operative form of organization is an important instrument for the Government in implementing its agricultural development plans.

84. Co-operatives offer an organizational framework for modernizing the traditional economic sectors of some countries. In Senegal, for instance, fishing with the traditional pirogue has been mechanized largely through the co-operatives.

85. Apart from legislation, the practical help of the State is indispensable for the development of co-operatives at the national, sectoral and local levels. It is the function of the Government to help the co-operatives by planned development and organization, enabling them, after a certain formative period, to take over the management themselves.

86. Prosperous co-operatives, regarded by the peasantry as their own institutions, may take part in the implementation of government plans in many different ways. They may operate as " agents " for the various sectoral and regional institutions.

87. In developing countries, agricultural co-operatives may constitute a new institutional form of agriculture, covering both horizontally and vertically this important economic and social sector.

88. So far as participation in capital formation is concerned, every type of co-operative may contribute to internal capital formation through share capital, reserves and insurance fees, following which the inventory of equipment increases and new premises and dwellings are built. The co-operative network in agriculture enables the Government to enforce a price policy whereby the monetary processes are directed towards investment.

89. Co-operative organization encourages the creation of surpluses, thus increasing consumption and promoting capital formation; part of the excess profits generated by the surplus products can be used directly or indirectly for investment.

90. The significance of co-operative training and education has implications which extend beyond supplying the co-operative movement with local officials.

91. The general institutional function of the co-operatives can develop if the chain of co-operative organizations ranges from the lowest to the middle and highest levels in the form of regional or national unions.

Chapter VII

Extension of the multiplier effect and integration of the domestic economy

92. Since the time of J. M. Keynes, the "multiplier effect" has been an important conceptual tool in development economies. The "multiplier" refers to the magnified impact that changes in investment spending have on total income. (For example, a $1 billion increase in investment will ultimately raise total income by $5 billion).

93. Foreign aid used for investment purposes also produces multiplier effects. But at present, the greater part of the multiplier effect of foreign aid remains within the donor country, where the amount of aid is spent by the developing country on equipment and other investment goods.[4] (This explains why developed countries give preference to tied aid.)

94. It is therefore neither rational nor desirable to maintain the present situation where the developing countries are using aid resources for importing basic and construction materials and relatively simple equipment needed for investment projects. National or regional production of such materials and equipment would turn the multiplier effect of investments financed from aid to the advantage of developing countries.

95. In order to extend the multiplier effect of investments in general (financed from both foreign and home resources) communication lines must be established between the centres of development activities and also between the different sectors and levels of the economy to transmit the main impetus of development energy and multiplier effect.

[4] For full particulars, see Goran Ohlin, *Foreign Aid Policies Reconsidered* (Paris, Development Centre of the Organisation for Economic Co-operation and Development, 1966), pp. 93-97.

96. It is not only specifically economic institutions that can be employed in the starting, spreading and integration of economic flows in developing countries. The institutional framework which gives impetus to economic growth and spreads the multiplier effect can consist of various types of organizations and their combinations.

97. One of the most important initiatives that can be taken by the Government or local organs is to establish and integrate market relations which transmit the multiplier effect, and to mobilize and co-ordinate for this purpose the various modern and traditional social organizations in whatever form they exist.

98. Measures for furthering the implementation of the plan must cover and integrate the entire process, from the preparation of production to the last phase of consumption. A production drive in agriculture can only be successful if, in the course of the preliminary spadework, all ancillary aspects, for example, the network for receiving goods, storage, transport, prices and consumer market, are also taken into account.

99. Direct action to initiate and integrate economic processes is almost the only way of quickly and smoothly blending the traditional sector into a country's main economic fabric. In Tanzania, for instance, development officers of considerable prestige mobilize the rural population for economic tasks in accordance with the aims of higher economic bodies and thus play an important role in drawing backward areas and communities into the main fabric of the economy. At a later stage, the economic results of the work done may generate a continuous and increasing impetus for raising production.

100. Any social or economic organization, be it modern or a traditional tribal community, may be a suitable means of spreading the multiplier effect and directly initiating and co-ordinating economic processes.

101. Given the conditions prevailing in the developing countries, it is particularly important to have a line of uninterrupted responsibility to follow each phase of commodity and money flows. This applies particularly to the taking over of foreign aid supplies and their dispatch to their places of destination.

102. Institutes and researchers concerned with applied economics in developing countries may be of great help in developing the instruments of "linkage", "spreading effect" and "multiplier effect" and the elements and lines of integration, by discovering and thoroughly analysing, for the country's economic policy, those ways in which or through which the inner integration and the multiplier effect can be strengthened by economic and political means even within the given structure, i.e., those ways which will promote "self-help".

Chapter VIII

The role of education and training

103. In this key area of social and economic life the speed of development in a given developing country is determined in the first place by the efforts and skills of its people.

104. The typical economic objective — the most rational use of restricted resources — calls for solutions in the educational field, too. Limited resources in this context mean, in the first place, a small number of trained men and women and a great lag of educational facilities behind the demand.

105. Every effort must be made to alter this situation. The importance of adult education and training is far greater in the education system of developing countries than elsewhere. The best way to promote it is the use of material incentives to encourage employees to attain higher levels of skill.

106. In State employment salary scales may provide a special incentive for advanced training, whereas in the private sector supply and demand lead to higher pay for higher skills. The salary scales fixed by the State are important regulators everywhere, for a substantial proportion of all employees are employed by the State; consequently the State can do a great deal to promote training and encourage study.

107. The other aspect of this policy of manpower economy is to create facilities for further training. Larger enterprises, recognizing their own needs, usually make provision for the further training of their workers but enterprises cannot be expected to organize or maintain training facilities which go beyond their direct requirements.

108. As one of the practical examples of help provided by the State let us mention Nigeria, where teachers can enrol in a two-year residential college to obtain higher qualifications. During this period they do not lose their jobs; the years spent on study are regarded as contributory service when it comes to promotions, increments, seniority and pensions, and they are even given pocket-money during the study period.

109. Adult education is economical from every point of view, for if suitable conditions exist, there are few drop-outs. Adults who are studying directly for promotion have so much at stake in their examination results that no comparable incentive can be provided in the education of young people.

110. Limited resources also necessitate effective economy in the education of young people.

111. The financial factor calls for Draconian measures: to speak plainly only the cheapest possible educational system can be maintained. Spartan accommodation; the maximum number of pupils per instructor; the elimination of all overlapping and superfluity; a very strict admission system into higher schools in order to keep dropping out to a minimum; vocational training; and adjustments in the level of the teaching staff — these are the basic requirements, and, if the principles of the school system used as a model are not compatible with this, then independent development is preferable to imitation.

112. Thrift, of course, affects the methodology of education. This must be accepted. For instance, the price to be paid for a British-type university life seems to us prohibitive. Let us mention Nigeria, with a *per capita* income of £30-40 a year, which spends approximately £1,000 on the average university student. A significant factor in raising the cost is the fact that the universities operate with a very small student body.

113. Unless economy is observed, it will be increasingly difficult to increase the number of places for students. Changes in the direction of extreme thrift are needed, particularly in the case of secondary schools and institutes of higher education. As a result of the rapid expansion of primary schools there will shortly be strong pressure on the secondary and higher education schools to admit many more students than today. With the present costs this is not feasible.

114. The planners and the conferences of the United Nations Educational, Scientific and Cultural Organization evaluated educational priorities correctly when they gave first priority to technical trades.

115. This principle must not be limited to the training of technicians and graduate engineers. Instruction in technical knowledge and skills must be organized even in primary schools and in secondary schools with other fields of specialization as well. A technical sense and an understanding of the basic principles of science are essential to update the thinking of the masses still in the wake of the twentieth century.

116. Some difficulty will obviously occur, if the school system is in the hands of organizations maintaining old traditions. In Nigeria, most secondary and primary schools are run by voluntary bodies. Although the State pays the whole of the salary received by teachers, their employment and dismissal are decided by the organization running the school. Technical education is alien to the tradition of these organizations whose ideals of learning are centred on the humanities.

117. The attraction of advanced countries presents a great difficulty, because it lures highly qualified cadres away from developing countries. It is scarcely possible to resist the "brain drain" by reducing the number of students sent to foreign universities. For several decades to come the countries of Africa South of the Sahara will not even be in a position to refuse foreign scholarships offered for studies in universities abroad.

118. What can be done to avoid such losses? Indemnity regulations calling for the payment of compensation would hardly be expedient.

119. There are only two ways of improving this situation. One is for the advanced countries to introduce administrative measures barring the employment of graduates from developing countries, let us say, for five years after graduation.

120. The other way is not administrative; it presupposes that the educational system and public life will develop such an attitude that every student and young person will consider it a patriotic duty to serve his country.

121. One of the principal ways in which foreign assistance promotes development is by providing the highly skilled people needed by the developing countries.

122. With regard to this most important part of assistance, the developing countries do not complain strongly enough that it is inadequate. In education

they are striving to replace foreigners in positions requiring highly experienced experts as soon as possible, and there are various plans calling for complete independence from foreigners in education within different, but always short, time-limits. Realistic forecasts suggest the contrary : even more foreign teachers will be needed in the next decades. Therefore advanced countries must carefully consider the numbers involved in providing for this need. In other words, they must take note of the fact that in the forthcoming decades, over and above their own requirements, they will also have to meet part of the need for qualified cadres in the developing countries. Not very detailed planning is envisaged by this suggestion but we certainly regard it as expedient, first perhaps for international organs and later for individual countries, to estimate what types of large-scale requirements will emerge in what areas of the developing countries. We attach importance not only to the quantitative planning of cadres for developing countries but also to their special education and training.

123. This type of training should be partly professional, partly social and, where needed, linguistic. It should be arranged for those who desire or have to work for a few years in a developing country.

124. We believe that this type of training should spread over many different levels, with different methods and organizational frameworks for the different trades and professions, including regular day courses, evening schools, correspondence courses, and seminars on special subjects and offered in the colleges and universities.

125. In the final analysis such training should be directed to two ends : *(a)* to prepare experts for their work in developing countries by equipping them with all the skills and information that can be passed on through formal instruction. To spare them most of the mistakes they would inevitably make in the first one or two years simply because of unfamiliarity with local conditions in their special field or in human behaviour ; *(b)* to keep track of those who would be willing to spend a few years or a longer period of time working in developing countries. This would facilitate recruitment, as the various organs of the developing countries could make offers in the first place to people who have received this type of training.

Chapter IX

Contribution of foreign trade to the implementation of development policy

126. Foreign trade plays a key role in accelerating the economic growth of developing countries.

127. What possibilities and tasks may be envisaged in respect of the expansion of foreign trade ?

128. The problem can be approached either from the viewpoint of the world economy, or from the inside, i.e. from the viewpoint of the domestic economy. Thus, economic necessity does not shape the foreign trade policy of developing countries but rather forces it to comply. Yet, their foreign trade policy, which must of necessity comply with world economic processes, can and should be included as a specific factor in the economic and political thinking of these countries. It is therefore desirable that their decisions in respect of foreign trade should have a " shaping " aspect in that they should aim at achieving a national economic optimum.

129. Among economic-political methods the special function of import duties is to promote the import-substituting sectors of the domestic economy and to stimulate regional co-operation. With respect to exports, customs duties used to contribute considerably to the capital formation, i.e. export taxes and duties constituted substantial income items in the budget. Owing to the aggravation of export problems, however, the scope for applying this means has been reduced.

130. The establishment of import taxes requires very careful study and greatly influences the attainment of economico-political targets.

131. The regulating function of exchange policy has been intensively used in Latin American countries (and also in Indonesia and the Philippines).

132. The development of a system of exchange permits is another alternative which can best be included in an economic policy designed to limit the influence of market forces.

133. The policy of organizing compensatory and barter transactions has a beneficial effect on development since it induces additional expansion of the turnover in the exchange of goods other than essential goods, and may also lead to the introduction of new ones. This policy may greatly enhance co-operation, especially in respect of industrial commodities. This economico-political activity may sometimes be relegated to certain alliances of producers (e.g. coffee producers, jute producers, co-operative centres, industrial federations etc.), State assistance being limited to reducing rates of exchange or to administrative privileges. In the absence of such institutions, a special State bank or a State or semi-State economic development agency may perform similar duties with monetary funds.

134. As experience shows, it may be useful to establish State or mixed funds in order to create new production capacities for promoting exports or to improve the quality of the products manufactured with existing capacities. For products of a better quality than the traditional domestic output it is expedient to grant price support. It is useful to have the same organization as the supplier of technical aid, for instance in the form of high-quality seed, chemicals, the transport of breeding animals and consultation by experts. Similar organizations have so far proved very successful in initiating Mexican and Colombian meat exports, and developing jute production in Pakistan and rice centres in Thailand.

135. In countries which have reached only a low level of development, economic growth cannot be started purely by market-type incentives. According to experience gained in Ethiopia and Tanzania, the economic development agencies organized to operate within a large action radius must assume a more and more all-embracing or comprehensive character including such activities as buying up the produce, possibly using incentives of price and credit policy, organizing minor investments, transport, the improvment of quality, and

education. The comprehensive approach has greatly contributed to the spectacular export achievements of Tanzania, and the organization of the Ethiopian Oilseeds Board also relies on the requirements of comprehensive operation. Vertical integration has been found to be more urgently needed the less advanced the economic environment of the given countries. For rapid success the example of Senegal may be quoted. There—thanks to the expedient organizational and credit-granting activities of the Government and to technical assistance from the Food and Agriculture Organization of the United Nations, fishing, based on old traditions, could be further developed on a considerable scale. All this shows that it would be a mistake to concentrate the organizational, economic and technical assistance of the State merely on the development of output capacity. The scope of the market for certain goods makes it impossible to realize sales of additional quantities; thus it is advisable to concentrate development on the qualitative or rational improvement of yields for export.

136. The working out of a system of measures for promoting regional co-operation is a new and encouraging economico-political objective. Of course regional co-operation proclaimed and advocated at the political level is not sufficient. A sound economic basis and a common will to co-ordinate economic development are essential.

137. Concerning the international aspects of their economico-political tasks, it is advisable for the developing countries to make greater efforts to conclude long-term agreements and contracts that will ensure the consolidation of their marketing positions and of their foreign trade relations and the promotion of a healthier development policy. Long-term agreements serve the main objectives of a developing country: by stabilizing essential branches of the economy they introduce an element of security and make planning more reliable.

138. An increase in turnover is only one of the results of long-term agreements. Their contribution in steering the structure of the economy in the right direction may be even more important.

139. The more the State can influence foreign trade and the more possibilities that exist for direct intervention by the Government, the more effective will be the agreements.

140. Besides long-term agreements, the mobilization of the producers of certain goods on an international, regional or subregional basis may turn out to be useful because such concentrations would make it possible to co-ordinate production policy and marketing policy and to form a common front. Both long-term agreements and alliances of producers—in addition to securing direct advantages—may stimulate the conclusion of international stabilizing commodity agreements with due regard to the interests of all countries concerned.

141. The main instruments of implementation are the institutional framework of foreign trade control and the personnel employed in foreign trade.

142. The principal aspects of the foreign trade mechanism are centralization or decentralization, direct or indirect methods of control and the institutional relationships between the directing organs. Many arguments can be put forward in favour of concentrating foreign trade activities in the hands of the State such as:

(a) a stronger negotiating position;

(b) better co-ordination of foreign trade policy with top-level decisions;

(c) the possibility of better foresight;

(d) better possibilities of co-ordinating market operations between the developing countries;

(e) the accumulation of profits from foreign trade.

143. Against the advantages enumerated above, there is the bureaucratization of trade and the danger of a slowing down of reflexes. Therefore the formation of an adequate staff is a precondition for the good functioning of State-owned enterprises. State control has proved particularly useful for major export and import items, for commodities in bulk, such as food, fuel and vehicles. However, the mixed forms of ownership have to be taken into account when a Government decides on its foreign trade policy and organization. In order to achieve relative uniformity in foreign trade policy, instruction must be supplanted by incentives. The use of subsidies and protectionism is unavoidable in developing countries and, though the influence of the world market cannot be excluded, its effects must be limited in order to facilitate progress towards an independent economy.

144. One of the economico-political methods of importance is planning. The relatively simple patterns of the national economies of the developing countries obviously permit large-scale planning of national growth. Owing to its specific circumstances, planning must emphasize such activities as the securing of ample and reliable information on world economic trends and on the outlook for the domestic economy in the following year, including forecasts, adjustments in the plan to bring it into line with changed conditions and the quick and efficient handling of "feedback" operations.

145. On account of the crucial importance of foreign trade and of the grave problems of external imbalance, it is desirable to strengthen the institutional role of the main organs concerned with foreign trade and to ensure that they have an adequate position for negotiating with ministries of finance, issuing banks and planning offices. For instance, since most of the activity of these organs centres around the implementation of tasks of internal development, they often lack the necessary experience and outlook so far as the world economy is concerned.

146. It is a paradoxical fact that in many developing countries the level of economic administration does not match the importance of the problems falling within the competence of the relevant institutions. The level of the State organs engaged in foreign trade is much lower than the Ministry of Finance or the issuing bank. In many countries the bodies supervising foreign trade cannot be strengthened radically and quickly because of opposition from an old-fashioned bureaucracy. In such countries, especially those largely dependent on the world economy, it is advisable to set up a central Ministry, or a government commission under the guidance of a deputy prime minister to deal with external economic relations, foreign trade, credit aid, and debt service.

147. The sufficiency or lack of cadres has a far-reaching impact on the evolution of the organization and machinery of foreign trade, and even on the formulation of foreign trade policy. The specific need for cadres is justified by the fact that they maintain the most significant foreign relations and their personal erudition should match, or at least not fall far behind, world standards. Foreign relations represent a simultaneous encounter and struggle with interests opposed to those of the country; hence the defence of national interests requires, besides a specialized education, a sound ethico-political attitude. The inadequate importance ascribed in a country's hierarchy to foreign trade is one of the causes of cadre shortage in this field. In Ethiopia and Tanzania, for instance, the number of those concerned with foreign trade at the ministerial level is so small that they are unable to participate in the development of foreign trade to the necessary extent. The shortage of cadres explains why there are no local representatives on important external markets and why nobody is commissioned to gather information on the spot. Many developing countries have the same problems. Efficient international help should be secured for the solution of these problems but in the first place the countries concerned should strive to strengthen their own apparatus.

Chapter X

Contribution of foreign resources to the implementation of development policy

148. The present inadequate effectiveness of assistance is due to various factors.

149. Among the causes of this inefficiency let us mention the negative aspects of international assistance policy, of the assistance mechanism and of assistance methodology. These negative features include the following:

(a) The present flow of aid is crucially affected by political considerations;

(b) Owing to the predominance of trade-developing credits, i.e., their stimulation by the State, developing countries are under great pressure to sell;

(c) Owing to the priority of trade development, external financiers are not interested in granting aid that does not contribute directly to the expansion of trade relations;

(d) Owing to the bilateral character of the flow of aid, assistance has not been co-ordinated either at the international or the regional level (not even on a national scale);

(e) The absolute and relative insufficiency of credits that can be used multilaterally makes it difficult for the developing countries to select partners, to reduce costs and to establish an optimal economic policy and division of labour;

(f) The aid-administering and controlling system of the financing countries is less flexible and more complicated and subject to protracted delays than it should be;

(g) It seems to be methodologically wrong that the bulk of the flow of aid is still made up of single projects and not of comprehensive development programmes. Establishments created under one project, though individually necessary, rarely constitute a comprehensive whole or interconnected chain, so, however up-to-date they may be in themselves, when put together they do not create a modern economic sector.

150. Factors deriving not only from financing but also from the recipient countries themselves are also responsible for the low efficiency of the aid.

151. The utilization of aid has, in most cases, not been included in long-term development plans. In many developing countries aid has not been used properly so far as the improvement of world-economic relations are concerned. Many developing countries have failed to make the necessary efforts to expand the scope of capital-absorption. Few developing countries have worked out a proper system of aid administration within their economic and State apparatus.

152. The points outlined above show that, by formulating a proper policy of aid utilization, the developing countries could make available for themselves substantial resources with which to improve the efficiency of the aid they utilize.

153. The main prerequisite for achieving a more efficient flow of aid is to visualize an assistance policy different from the policy pursued today by donor countries.

154. Owing to the nature of the financing needs of the developing countries, the extension of multilateral financing is indispensable.

155. It would be desirable to concentrate the economic activities of the United Nations connected with the developing countries on the extension of multilateral funds.

156. Multilateral contributions should be permitted not only in hard currency but also in goods, in experts, and possibly in local currency. In addition to this, participation in multilateral assistance on a bigger scale, i.e. the acceptance of a gradually increasing share in financing, would not overburden even the smaller of the advanced countries.

157. The framing of a policy of aid utilization common to developing countries situated next to each other and the implementation of large-scale aid projects with the participation of several developing countries are essential elements of economico-political work. The establishment and the activity of the Comité inter-Etats pour l'aménagement du fleuve Sénégal constitute a worthy example of regional co-operation between developing countries.

158. The strengthening of the elements of co-ordination in international assistance may have a marked impact on the improvement of efficiency. The organization of such co-ordination, i.e., co-operation, is at present the responsibility of the United Nations.

159. The work of co-ordination may be implemented by the regional economic commissions of the United Nations or by the United Nations Conference on Trade and Development (UNCTAD).

160. The most important aspect of passive assistance policy is to prevent aid from having a detrimental effect

on development, and to steer it in the desirable direction of economic development.

161. It is advisable to be highly selective in adopting norms of passive assistance policy with respect to aid targets, the technology used and the conditions of assistance. This selective policy — beside its domestic interest — is of paramount importance, since the financing countries themselves, particularly the international monopolies and financial groups, pursue an extremely selective assistance policy towards the developing countries with due regard to their own interests. Leaving aside emergencies, it still depends on the decision of the developing country :

(a) whether it accepts or refuses certain possibilities of external financing ;

(b) to what organ it addresses its request for aid for a definite purpose ;

(c) what specific sums it asks for within the global amount of aid ;

(d) whether it wishes to be financed from private or by State resources ;

(e) what countries it accepts aid from, etc.

162. Thus the developing countries have at their disposal various means of influencing the flow of aid. Nevertheless, they must have their own ideas about utilizing the assistance which must not depend on improvisations and external initiatives.

163. The precondition for a rational and efficient assistance policy is the long-term economico-political conception, usually referred to as " the plan ".

164. Another way to improve the efficiency of aid utilization is to set up an effective system of aid administration.

165. The principal functions of the authority responsible for aid administration in a given country should include assistance in market research, in planning and in policy.

166. It is of great importance to plan the correlative proportion of the various types of aid embodied in capital goods, consumer goods and intellectual imports. Improvement in the ratio of technical assistance increases the efficiency of production, yields higher profits, ensures better accumulation possibilities, and generally enhances the capacity to absorb the aid.

167. It is the duty of the organ responsible for assistance policy *(a)* to evaluate the practical possibilities of assistance on the basis of information from the aid market and of the utilization plans ; *(b)* to conduct negotiations concerning the acceptance of assistance ; *(c)* to make the necessary decisions and then to ensure smooth utilization, and *(d)* to control the work of the special organs and institutions responsible for implementation.

Chapter XI

Research work on the problem of execution

168. The most important groups of problems which appear collectively only in the developing countries are the following :

(a) The lack of cadres and, as a corollary, the special role of experts and specialists from abroad ;

(b) The special role of the State and community organizations in furthering economic development ;

(c) The importance of foreign capital, foreign trade and aid in economic development ;

(d) The weight and importance of the traditional sector ; social institutions and groups acting as a brake on economic development.

169. Without attempting to present a full picture, let us mention some characteristic subjects of research relating to the groups enumerated above.

(a) *Lack of cadres :*

(i) Quantitative and qualitative assessment of the staff and employment of cadres ;

(ii) Education during work-time and adult education ;

(iii) Development of a relatively effective school system that takes into account the lack of cadres and of material resources ;

(iv) The most expedient ways of selecting, recruiting and training experts and specialists from abroad and of putting them to work.

(b) *Special role of State and community organizations in furthering economic development :*

(i) Experiences of executive State enterprises and other State-owned bodies, the ways and means by which the State stimulates and influences various branches of the private sector ;

(ii) The position of the planning office in the hierarchy of public administration, its practical and legal role in implementation of plans ; responsibility for implementation and control of plan fulfilment ;

(iii) The organizational framework and economico-legal measurements for promoting the achievement of the targets of domestic saving, industrial investment, agricultural production, etc. ;

(iv) The organizational problems of public administration, the forms of local self-government, the disseminated effect of central decisions, etc., require the thorough study of a number of administrative and organizational questions ;

(v) The activities and functions of community organizations representing strata or branches of the modern sector (labour unions, co-operatives, cultural societies, etc.) pose many questions worth studying.

(c) *Foreign capital, foreign trade and aid :*

(i) Regulations governing collaboration with foreign private capital ;

(ii) Direction of foreign trade at the government level, organizations for implementing trade policy, and financial questions bearing on trade, co-ordination of foreign trade decisions with other organizations of public administration, cadre problems of foreign trade ;

(iii) Formulation of aid policy and of the role and function of the institutions established to render assistance in the countries providing aid ;

(iv) Study of the aid-mechanism with special regard to the extent to which the system is suited to determining correct priorities ;

(v) Co-ordination of the purposes of aid with the plan targets and the problem of timing.

(d) *The weight and importance of the traditional sector :*

(i) The problems of transforming social and ethical institutions in order to restrict the traditional sector and to make the functioning of the modern sector efficient ;

(ii) Rules and customs hindering development, the extent of their influence, and ways of overcoming these kinds of obstacles ;

(iii) The place of traditional leadership and its impact on development especially on land ownership and the modernization of agriculture, measures ranging from educational to legal ones, which promote the transformation of the large type of " family " unit (village, tribal) based on the principle of " collective production and equal distribution ".

170. The research problems relating to execution which we suggested above, without claiming that they are complete, call primarily for comparative studies.

171. Comparative research is the most suitable way of selecting from the different solutions the most effective ones, and at the same time it makes it clear why different methods have to be applied at the various levels of development in different economic, social and intellectual environments.

172. Intensified research on execution can be greatly facilitated if the international organs playing an important role in the control and direction of scientific research use the material and intellectual resources at their disposal to direct the attention of researchers to these problems. This would not only make it easier for the Governments of developing countries to arrive at the right conclusions by their specific decisions on implementation, but would also produce a no less important side-effect : it would emphasize the importance of execution and help to eliminate the kind of leadership which is satisfied with the announcement of high-sounding aims but does very little to overcome the obstacles on the road to achieving those aims. Intensified research helps to make the inseparability of the plan and its execution a matter of public knowledge and it promotes the widest possible understanding of the responsibility of leadership. Of the many things that have to be done for economic and social progress in the developing countries, this is certainly one of the most important.

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A study on the independent international evaluation of national development efforts*

by P. N. Rosenstein-Rodan

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Introduction

1. International aid to developing countries, like lend-lease in its time, represents a new institution in international economic relations. Its purpose is to accelerate economic development up to a point where a satisfactory rate of growth can be achieved on a self-sustaining basis. Its aim is equality not of income but of opportunity; not to equalize income in different countries but to provide every country with an opportunity to achieve steady growth. The primary criterion for allocating aid is thus to maximize additional national effort, not to maximize income created per dollar of aid.

2. There is a natural credibility gap as to whether such a primary criterion will in fact be applied. Justified or unjustified suspicion that aid-giving might be used to obtain other concessions, that it will be subject to political or economic strings, impedes discussion of what measures are needed and are possible to increase or to optimize national effort. The incentive effect of aid as a catalyst of (and not a substitute for) often painful and difficult national development measures is weakened. The very discussion by a credit-giving country of what the receiving country should do invariably raises objections that the latter's national sovereignty is being infringed. In such circumstances, the discussion is either incomplete and not explicitly articulated or it is bound to give rise to bad blood and mutual recrimination. In practice, both effects occur in a varying mix of disadvantages. It is natural, therefore, that from time to time there have been, in the post-war years, demands for the establishment of procedures for an independent evaluation of national development efforts, the results of which would be acceptable to both the donors and the recipients of aid. An impartial international evaluation is an attempt to reconcile the legitimate interests of both parties, avoiding thereby the friction that could result from potential differences of opinion between them.

3. The creation of the International Bank for Reconstruction and Development (IBRD) in 1946 marked the first major agreement to allocate aid by an international agency in accordance with some internationally agreed principles. It was a step in the right direction, but it cannot be said truly to represent an independent international evaluation of national development efforts. That idea gradually developed with the practice and the doctrine of IBRD, beginning with joint comprehensive survey mission reports arranged by IBRD and the respective Government, starting in 1950.[1] The reports of the survey missions, however, were a basis for the selection of projects to be financed by the Bank rather than for a firm decision to finance a development programme as a whole. In one case only, before 1958, did the Bank finance a development programme as a whole: that was in 1951, when a series of loans were granted for the development of southern Italy. The amount of the loans was determined by the nature of the programme as a whole, although single loans were attached to specific projects. During the first decade of its operations, IBRD in fact confined itself to project loans. Its official statement that "the Bank would prefer to go further, wherever that is feasible, and base its financing on a national development programme, provided that it is properly worked out in terms of the projects by which the objectives of the programme are to be attained"[2], remained platonic. The Bank also realized the main shortcomings of single project loans: "The Bank recognizes, of course, that by financing one particular investment project it may be releasing resources already available to the borrower for some other investment activity. This is the principal reason why the Bank seeks to consult with its member countries not only concerning the merits of projects for which a loan is requested but concerning the country's projected investment expenditures as a whole."[3] Apart from a project report, each loan, therefore, also led to an economic report on the country, but its main emphasis was to assess, first, the country's capacity to repay loans, secondly, the general order of priority of projects under consideration and, lastly, the appropriateness of the Government's economic and financial policies to further the development process. The survey mission reports had an educational effect not

* This study by P. N. Rosenstein-Rodan, Professor of Economics, Massachusetts Institute of Technology, was prepared at the request of the UNCTAD secretariat. The views expressed in the study do not necessarily reflect those of the secretariat.

[1] IBRD reports on Colombia (L. Currie), 1950; Guatemala, 1951; and Uruguay 1951, published by IBRD, Washington D.C. Beginning in 1952, the following reports were published by the Johns Hopkins University Press, Baltimore, Md.; Iraq, 1952; Jamaica, 1952; British Guiana, 1953; Mexico, 1953; Nicaragua, 1953; Ceylon, 1955; Malaya, 1955; Nigeria, 1955; Libya, 1960; Venezuela, 1961; Uganda, 1962.

[2] IBRD, *Fifth Annual Report, 1949-1950* (Washington D.C.), p. 8.

[3] *Ibid.*, p. 9.

only in the countries concerned but also in the Bank to shift the emphasis towards an assessment of the main outlines of a development programme. While the progress was gradual, the first report incorporating that spirit was perhaps the IBRD report on India in 1958. It is in this spirit that most IBRD country reports are written in the 1960s.

4. Progress towards an evaluation of a nation's development programme as a whole, rather than of single parts of it in the form of projects, was gradual and slow and was accelerated only under the impact of the "Three Wise Men" mission to India—which was not an IBRD mission—and of the consortium loans initiated by the India consortium under the guidance of IBRD in 1958. Nevertheless, the principle of a multilateral decision and of concerted action was already largely, although not wholly, secured by the very fact that a multinational agency such as IBRD, and later the regional development banks (Inter-American Development Bank, African and Asian Development Bank), and not a single national government, acted both in evaluating and in lending. What Milton Eisenhower cites as the advantages of the Inter-American Development Bank (IDB) is thus true of all such multilateral organizations: "First, decisions on loan applications would be made co-operatively; thus there would be no justification for identifying the United States with project development that, while improving the economics, continues to strengthen the prevailing order. Second, if conditions were attached to loans, in the hope of spreading more widely the benefits of economic growth, the intervention involved or implied would have been collectively determined. In other words, an agency of the Americas might help to solve the dilemma: desirable social changes might be fostered through credit, while avoiding malodorous charges that had arisen as the United States sought sincerely but unilaterally to promote economic development in Latin America."[4] The Bank through its survey missions, its sponsorship of more consortia and consulting groups and also through its gradually increased emphasis on evaluating a development programme had a headstart and has made in this one important respect a greater contribution, so far, than the regional development banks. But, although a multilateral agency, its voting power is strongly weighted in favour of the group of creditor nations. The regional development banks are not only multilateral agencies but also have a higher voting power of developing countries, which enhances the validity of their co-operative collective decisions.

Chapter I

Delegation of decisions to allocate aid: from the Marshall Plan to the Alliance for Progress

5. The Marshall Plan—a co-operative effort for the reconstruction of Western Europe—introduced clearly the principle of a *de facto* (not *de jure*) delegation of decisions to allocate aid. The ministerial committee of its organization—the Organization for European Economic Co-operation (OEEC)—"decided", on the basis of studies of a committee of technicians appointed by Governments and of its secretariat, the allocation of annual aid among the participating European countries. Legally, the OEEC allocation decisions were mere recommendations. Nobody doubted, however, that the recommendations—short of extraordinary reasons and circumstances—would be accepted by the United States Government, which had made a declaration of intent to allocate aid according to such recommendations, and in fact did so; the system worked smoothly during the second half (the third and fourth year) of the Marshall Plan.

6. The Marshall Plan's criterion for aid allocation was somewhat simpler than that of a general development programme—it was, after all, a reconstruction, not a "construction" plan—namely, to cover the dollar balance-of-payments deficit, assuming that the national effort to reduce it was sufficient. The judgement as to whether the effort was sufficient was in fact delegated to OEEC. Since the primary object was to reduce the balance-of-payments deficit, less emphasis was paid to the allocation of aid funds to single projects. It should be remembered, moreover, that, even though the administration of the so-called counterpart funds presented some difficulties similar to those of development, those difficulties were largely overcome because the head, or a high official, of a Marshall Plan mission had direct contact and co-operation with the Minister for Economy or Finance or a corresponding high national official about the total economic policy of the country. Those contacts, crystallized in an over-all view, had priority, while details of technical assistance about single projects tended to be in the background.

7. While the Marshall Plan clearly introduced the principle of multilateral co-operation and of the *de facto* delegation of decisions to allocate aid, it did not achieve all that might be achieved in the evaluation of national development efforts: it was multilateral but not independent. Decisions to allocate aid were taken by a ministerial, i.e. a political committee, not by a committee of independent experts. The Marshall Plan represented important progress towards, but not the full realization of, an independent multinational evaluation which alone can effectively remove all suspicion of "political strings". But even political decisions on economic policy are taken differently in the 1960s. The economic rationale worked out by an expert secretariat forms a backbone and a constraint which politicians and statesmen have to respect and can only partly twist and change. The Council of Economic Advisers in the United States and its equivalents in other countries have only advisory, not decision-making, functions. Governments are largely influenced by them, however, and the very process of having to expound an economic rationale for political decisions largely changes and "functionalizes" their policies.

8. Decisive progress in the formulation of the doctrine of multinational independent evaluation of national development efforts came from Latin America. In 1954, the Economic Commission for Latin America (ECLA) set up a group of experts to work out a report on ways

[4] Milton Eisenhower, *Historic Roots: "The Alliance for Progress"* (Johns Hopkins Press, Baltimore, Md., 1962).

in which international economic co-operation could be reinvigorated; that report[5] was then submitted to the meeting of Ministers of Finance and Economy of the American Republics held at Quitandinha, Brazil. The report accepted largely the basic ideology of ECLA and contained most of the principles later incorporated in the Charter of Punta del Este (1961)—except for the special emphasis on social progress which was included later in the Act of Bogotá (1961)—and notably three. The first was the need for planning national development in order to make optimal use of international economic co-operation. The second was the need for long-term pledges of external resources which would supplement the increasingly mobilized additional national resources. Continuity of aid is often even more important than the amount. Those two principles were taken up again in 1958 by the Operation Pan America presented in an aide-mémoire by the Brazilian Government. The third important principle stressed the need for both a multilateral and an independent evaluation.

9. A development programme is essentially a consistently formulated system of economic policy. It should be evaluated on the basis of the correctness of policy. But who should do the evaluating? The policy should not be framed simply by those who are contributing resources. There should be a separation between programming and financing. An independent "committee of wise men" should evaluate the development programme, its consistency, and notably the adequacy of national effort on the basis of which it would assess the amount of external resources needed and justified. International agencies and Governments would agree to tender aid according to that recommendation. Internationally agreed criteria, tested and applied by an international committee independent of both creditors and debtors, would remove the frictions which result from political suspicions. Such a committee should therefore be able to insist more emphatically on some efficiency conditions and could thereby achieve better results. The evaluation of a development programme on functional lines would to a very large extent "depoliticize", streamline and "functionalize" the negotiations on economic development.

10. In an internal paper of the group of experts convened by ECLA in 1954, the hope was expressed that such a committee of experts would receive an international mandate to assess the national and international effort required for all international development aid. The finally published report modified the approach in two respects: it said first that such a committee should be convened only in "certain cases" and, secondly, that its findings should be recommendations and not mandatory. The basic principle of both a multilateral and an independent evaluation was, however, maintained:

> "That in preparing internal measures aimed at facilitating the full utilization of international co-operation it might, in certain cases, benefit the Latin American countries to receive the prior opinion of an independent group of experts;
>
> "That owing to the confidence this group might inspire in the interested governments and international credit institutions, the advice of such experts could also contribute to harmonizing different points of view and facilitating negotiations;
>
> "That in order to discharge their duties to the best of their ability, the experts should act in a personal capacity and as entirely independent of the institutions appointing them."[6]

11. Even that modified recommendation did not prove acceptable at Quitandinha. Acceptance of the requests for specific long-term pledges of aid for national development programmes and for a delegation of decisions to allocate aid was regarded as *de facto*, if not *de jure*, impossible. The further evolution of Latin American thinking on international co-operation in development —through the Operation Pan America 1958, followed by the lengthy (twenty months) bureaucratic process of the Committee of Twenty-One, then an additional aide-mémoire from Mr. Kubitschek, President of Brazil to the President of the United States up to the Act of Bogotá in 1961, which established the Inter-American Development Bank (IDB) and a special fund for development earmarking resources for social development to be handled financially through IDB—is excellently described by H.A. Villa and R. Saez.[7] While the need for a multilateral partnership in development was accepted, no effort was made to deal explicitly with the problem of a multilateral independent evaluation of national development efforts. The latter concept—rejected as unrealistic in 1954—became realistic and was accepted by President Kennedy at Punta del Este in August 1961, when the Alliance for Progress was established.

12. Outside Latin America some progress in multilateralization was achieved in the late 1950s through the technique of consortia and later on through consultative groups. In 1949-1950, IBRD undertook a successful mediation leading to joint action by India and Pakistan in the Indus river basin. The "Three Wise Men" mission to India and South East Asia in 1953 was an isolated attempt to present to the world an independent multinational assessment of development needs, in the hope that the moral weight of the findings would lead to action by Governments and international agencies. In that sense it was not unsuccessful, since it contributed to decisions to increase lending to India and Pakistan. The mission had its own secretariat; IBRD provided the logistics but was not responsible for the findings.

13. In August 1958, IBRD established a consortium for aid to India. The initial meetings to cover the

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[5] *International co-operation in a Latin American Development Policy* (United Nations publications, Sales, No.: 1954.II.G.2).

[6] *Ibid.*, part II, p. 136. Part II of this publication is the report containing the conclusions and recommendations of the group of experts, composed of Eduardo Frei (Chile), Evaristo Araiza (Mexico), Cleantho de Paiva Leite (Brazil), Carlos Lleras Restrepo (Colombia), Rodrigo Facio (Costa Rica) and Francisco Garcia Olano (Argentina). Part I contains the preliminary report prepared by the secretariat of ECLA.

[7] Hernando Agudelo Villa, *La revolución del desarrollo*, Mexico, Editorial Roble, 1966, and Raúl Saez, "Global partnership: agencies on development," in *International Organization*, Boston, Mass., World Peace Foundation.

requirements of the last two and a half years of the second plan period indicated only broad magnitudes of aid which participating members intended to make available. Authorizations of aid subscribed by eleven participants between 1961-1962 and 1965-1966 amounted to $4,698.7 million. The second consortium organized by IBRD was for Pakistan in 1960. The consortium aid pledges in 1961/62-1965/66 amounted to $2,050 million. Other consortia were established by OECD for Greece in 1960 and Turkey in 1965. Consultative groups were established by IBRD for Colombia (1963), the Republic of Korea (1966), Malaysia (1966), Sudan (1964), Thailand (1965), Tunisia (1962), as well as for Morocco, Nigeria and Peru. IDB established a consortium for Ecuador in 1965.

14. The advantage of consortia and consultative groups is not only that they mobilize resources from different countries or agencies, but also that they assess the country's development effort and strategy as a whole instead of limiting its attention to single project analysis. The agencies organizing consortia have so far been international agencies (IBRD, OECD, IDB), thus introducing to some extent the principle of multilateral decision. Each consortium attempts to co-ordinate all sources of external borrowing by and lending to each country. In spite of this advantage of multinational financing sponsored by a multilateral agency, the consortium technique is only one insufficient step towards a co-ordinated international aid policy. It stops short of any *de facto* delegation of decisions to lend. The evaluation of a country's development programme provides valuable information which may induce creditors to lend but need not lead to the recommended volume of aid. Even assuming that each of the consortium reports is based on the same criteria for allocation of aid which will gradually be the case—it is still entirely uncertain, and a matter of chance, whether each country will in fact receive the suitable amount and composition of aid. This will be possible only if one, some, or all countries, or international agencies, is willing to " underwrite " the residual amount of aid, i.e., the amount required to make up the total lending appropriate for each country. Without such international agreement to constitute a " loan fund of last resort ", the consortium technique cannot prevent the amount and composition of aid available to an underdeveloped country from depending on the haphazard willingness of various countries to provide the necessary quota of both conventional and unconventional loans. The undesirable result might be that country A would receive all that is recommended, while country B received less. Some countries might be willing to finance the attractive-looking projects and, having picked the plums, leave the rest to other sources of financing. Consortia established for different countries may represent in international financing the equivalent of the single project approach instead of the programme approach. In the same sense in which single projects do not add up to a programme, individual consortium decisions need not result in an appropriate level of external aid for the various countries.

15. One form or another of underwriting a " loan fund of last resort " must logically complement the consortium technique. That, however, requires an independent international evaluation of national development efforts to be supported by an effective undertaking on the part of the parties concerned to accept recommendations on the allocation of aid made by one co-ordinating committee (or more) set up for that purpose.

16. Progress towards a *de facto* delegation of decisions to allocate aid has been achieved in the Alliance for Progress. Even though the principle has so far witnessed more lip service than actual application, it represents a decisive step forward in the doctrine of international aid.

Chapter II

The Alliance for Progress: Role of the Committee of Nine and of the Inter-American Committee on the Alliance for Progress (CIAP)

17. What appeared impossible in 1954 at the Quitandinha Conference became possible in August 1961 at Punta del Este when the Alliance for Progress was created. The Kennedy administration in fact accepted the main Latin American proposals for a multilateral programme, including long-term pledges of aid which would supplement additional national efforts; the need for planning national development in order to make optimal use of international economic co-operation and, last but not least, the establishment of an independent international body of experts to evaluate national development efforts. The evaluations of that body, which was officially entitled the Committee, or Panel, of Nine (and was popularly known as the " Committee of Nine Wise Men ") were to guide the allocation of external resources to member countries. The principle of multilateral decision was accepted, and the United States Secretary of the Treasury, Douglas Dillon, stated: " If a group of highly capable and impartial experts were established, my Government would expect their recommendations to be very important when deciding how to spend our resources for the development of Latin America. We would expect that other friendly Governments, potential suppliers of capital, would also accept these recommendations from the experts as a major factor in their decisions about help for Latin America. " However, the functions actually assigned to the Committee of Nine had a more limited scope. The Charter of Punta del Este states in fact: " Each Government, if it so wishes, may present its programme for economic development for consideration by an *ad hoc* committee composed of no more than three members drawn from the panel of experts referred to in the preceeding paragraph, together with an equal number of experts not on the panel. " The panel appears, therefore, as nothing but a list of names from which *ad hoc* committees for the evaluation of national programmes should be formed. The submission of a development programme to those committees is not compulsory and their reports can be released only if the interested country consents. The Charter does, however, acknowledge the fact that " the recommendations of the *ad hoc* committee will be of great importance in determining the distribution of funds under the Alliance for Progress

which contribute to the external financing of such programmes ".

18. It is noteworthy that the members of the Committee of Nine were independent of Governments and therefore both of debtor and creditor countries. No single country could influence this body or its composition. The committee consisted of seven Latin Americans, one United States national and one European who were not responsible to any of the Governments concerned. They were elected by the Council of Ministers of the Inter-American system on the proposal of three Latin American institutions, the Organization of American States (OAS), the Economic Commission for Latin America (ECLA) and IDB, to which CIAP was subsequently added.

19. Despite its limited functions and scope, the establishment of a multinational independent committee of experts whose judgement would guide the allocation of aid represented a great innovation in international relations. Their recommendations were not only directed to suppliers of external resources but also focused on what had to be done to step up national development efforts. Since national efforts were necessarily to provide the majority (80 per cent) of total investible resources, while external aid would provide 20 per cent of those resources, the new institution—had the innovation worked successfully—would in fact have brought about a reversal of the burden of responsibility from the contributor to the receiver of capital aid.

20. The role and functions of the Committee of Nine were considerably strengthened when the Committee worked out a set of regulations for its own work, which it applied and submitted in its report to the first annual meeting of the Inter-American Economic and Social Council (IA-ECOSOC) at the ministerial level on 27 October 1962 in Mexico.[8] The decisions of the committee were officially recognized in resolution A-6/M 62, adopted at that meeting. The regulations provided that each *ad hoc* committee evaluating a country's development programme should consider itself a sub-committee of the Committee of Nine as a whole. That alone would make it possible to apply common evaluation criteria. The committee stated that, in every case, it would consider external aid as supplementary financing for a development programme as a whole.

21. The functions of the committee should, strictly speaking, have been those of evaluating national efforts and recommending the amounts of external aid appropriate to supplement them. However, the multinational co-operative character of the Alliance for Progress naturally involved many other activities. In the absence of any other multinational body that could represent the Alliance, the Committee of Nine began to undertake these activities "discreetly and firmly".[9] On the other hand, the Committee of Nine felt that, in accordance with its role as an independent international evaluating authority, it ought to confine itself to an assessment of required amounts of internal and external resources without having to negotiate with various national and international agencies for the implementation of that recommendation. It considered that implementation should be left to another multilateral but political agency. It therefore proposed a revision of the machinery of the Inter-American System. In Mexico, in October 1962, OAS designated two leading Latin American personalities—Mr. Kubitschek, former President of Brazil, and Mr. Lleras Camargo, former President of Colombia, to propose such new machinery. On the basis of their report, the Committee of Nine presented for the consideration of IA-ECOSOC in São Paulo in November 1963 a proposal for the establishment of the Inter-American Committee on the Alliance for Progress (CIAP).

22. The reasons for the establishment of CIAP were mainly twofold : to express the multilateral character of the Alliance, and to safeguard the independent character of the Committee of Nine's evaluation processes by assigning the political implementation of their reports to CIAP. The evaluation procedure of the Committee of Nine involved a separation between programming and financing; it concentrated on the evaluation of programming. Such evaluation was not qualitative but quantitative, leading to conclusions about, first, the adequacy or inadequacy of national effort and, secondly, the amount of external resources required and recommended. While considerations as to the composition and form of external resources could be added, distinguishing between soft and hard loans, and the proportion of loans available for local expenditure, no attempt was made to apportion the global amount of external resources among the various sources (international agencies and Governments). The negotiations with those agencies, as well as the negotiations with Governments submitting programmes for evaluation on how to implement the recommendations, were to be the task of CIAP. CIAP thus logically complemented the action of the Committee of Nine; far from there being a conflict, there is complementarity between programming and financing. An independent international evaluation is logically followed by negotiations to implement the resulting recommendations.

23. The Committee of Nine proposed in São Paulo in 1963 that CIAP should execute, co-ordinate and represent multilaterally the programme of the Alliance for Progress. Among the executive functions of CIAP proposed by the Committee of Nine the most debated at the São Paulo meeting was that of deciding about the allocation of Alliance funds according to the recommendations of the *ad hoc* committees responsible for the evaluation of the programmes. The proposal, because of its far-reaching political implications, had to be considerably modified. In practice, CIAP was granted the power to make recommendations, and the United States, through its representative, Averell Harriman, undertook to give great weight to those recommendations.

24. CIAP proceeded to organize annual country studies which were to evaluate the development programmes of all Latin American countries and notably the progress accomplished in implementing them. In

[8] See OAS document series 4, Pan American Union, Washington, DC, 1963.

[9] R. Saez, *op. cit.*

those cases in which there existed evaluation reports by *ad hoc* committees of the Committe of Nine, the CIAP country studies took them into account. The reports of the Committee of Nine evaluated a long-term (five or ten year) plan of orientation as well as the operative plan indicating how the orientation plan was to be implemented during the next year. The CIAP country studies were progress reports with additional emphasis on the operative plan, involving three tasks: first, to compare and contrast the *ex ante* projections and the *ex post* realization, and to establish reasons for any discrepancies; secondly, to elaborate the next stage of the orientation plan after one or more years had passed since the last long-run evaluation, (if discrepancies were great between *ex ante* and *ex post* projections and were not due to accidental or exceptional circumstances, a re-elaboration of a changed orientative plan might have to be undertaken); and thirdly, to elaborate the operative plan for the subsequent year.

25. In addition, CIAP was also to undertake the evaluation of such development programmes as were not submitted to the Committee of Nine for evaluation. In the longer run it was of course hoped that all countries would submit their plans to the Committee of Nine. Practical experience of evaluation by the Committee of Nine and to some extent also that of the country studies of CIAP are considered in section IV of this study.

26. It must be remembered that CIAP, like the Marshall Plan Committee of OEEC, is a multilateral but not an independent body; its members are appointed by Governments and are not independent experts. As their recommendations were to be based on an independent multilateral evaluation by the Committee of Nine, the functional, apolitical character of those recommendations would be manifest. The remaining part of their recommendations refer to measures necessary to implement and to negotiate the application of such principles. Even if such recommendations were not based on the findings of an independent body but only on studies of a staff committee of economists, that would still be very much better than a strictly bilateral loan negotiation. To the extent, moreover, to which CIAP bases its findings on fuctional economic considerations indicated by its advisory secretariat, this represents a substantial advance over a purely political negotiation. However, a lack of separation between programming and financing tends to blur the process of international evaluation.

27. The principle of multilateral independent evaluation incorporated in the Alliance for Progress—even in its weakened form—did not receive the enthusiastic support of Governments, despite the lip service paid to it. "The Alliance—contrary to its basic philosophy—was more and more considered as a way of obtaining aid, not as an inherent part of an integrated development task, not as a catalyzer, but sometimes as a substitute for national effort. To obtain more aid seemed easier and more familiar in bilateral talks... To submit aid decisions to a functional independent judgement, which is the backbone of the Alliance for Progress and of any enlightened international aid policy, received less and less lip service until it was practically dropped at the Buenos Aires CIES conference in March 1966. To submit aid decisions to an independent judgement implies, of course, a sacrifice and limitation of national sovereignty, as do all measures of progress in international relations." [10] At that conference it was proposed that the experts of the Committee of Nine should become an advisory staff of CIAP. Such a decision seemed to be a serious mistake: "to mix the technical, impartial judgement of the plans and other responsibilities of the Nine Wise Men with the decision of those who must carry out a political implementation is to join two elements that should have been kept apart". [11] So great a change in the whole concept of the Alliance for Progress seemed to be involved that all the members of the Committee of Nine resigned in April 1966.

28. The independent multinational evaluation agency set up in Punta del Este in 1961 thus came to an end in May 1966. The progress which had been achieved—from the *de facto* delegation of decisions under the Marshall Plan to a multilateral, but political ministerial committee of OEEC, to a fully independent multinational committee under the Alliance for Progress—was not maintained. Time alone will show whether the experiment was premature or superfluous. It should be remembered, however, that the less perfect organization of the Marshall Plan—with admittedly a less difficult task—was a conspicuous and undisputed success. Imperfect tools handled well may achieve more than better tools handled imperfectly. If we are not perfectionists, considering the better to be the enemy of the good, then we should recognize that the statutes of CIAP, with functions similar to those of OEEC, could give it ample power to influence decisions. The declaration of the Presidents of America in April 1967 again pledged vigorous support to the Alliance for Progress, emphasizing its multilateral character. The so-called Fulbright amendment, introduced in 1966 to the Foreign Assistance Act, does not confer a full or positive mandate of decision-making, but it does establish the need for approval by CIAP for otherwise bilaterally negotiated loan agreements: "Loans may be made under authority of this title only for social and economic development projects and programmes which are consistent with the findings and recommendations of the Inter-American Committee of the Alliance for Progress in its annual review of national development activities." Notwithstanding certain weaknesses, CIAP could play a very important role in multilateral decisions on Latin American development.

Chapter III

The meaning of multilateralization. Criteria for the evaluation of national development programmes

29. International action for economic development should be a partnership according to the modern development creed. The conditions are not unilaterally

[10] P. N. Rosenstein-Rodan, "*La Marcha de la Alianza para el Progreso*" in *Visión*, New York, 1966.

[11] Raúl Saez, *op. cit.*

imposed, but are mutually agreed upon. The meaning of multilateralization does not refer primarily to: targets, projects (including even multinational projects) or forms of administration (national or multinational), but fundamentally to the spirit in which policy is conducted and to the criteria governing the evaluation of development programmes by an independent multinational body with an operational conclusion—which should command enough moral prestige to be accepted and applied—as to how to allocate external aid resources.

30. While targets have been commonly proclaimed as consisting of three main groups: rate of growth, improved income distribution and social progress, and achievement of the above two targets within the framework of an open society with evolutionary democratic methods, the relative importance attached to each of these aims, which in the short run are largely in conflict with each other, is strictly a matter of national, not international, responsibility. Any progress in achieving those targets (for instance, an increase in investment represented by an additional investment project) is a matter of national responsibility but of multinational concern. The evaluation of the national effort to achieve those targets should be a multilateral function delegated to a multinational and preferably independent body. The same principle also applies to the administration of aid funds.

31. This administration should proceed by applying principles agreed upon multilaterally. It is not necessary, even were it desirable in the long run, that the administration of all aid funds should be concentrated under one international flag, provided that the various national and international aid administrations operate according to the same multilaterally agreed principles. This might be called " bilateral aid in a multinational framework ".

32. Aid should be allocated to different countries according to the same principle. Its primary aim should be to maximize additional national effort. If the additional efforts of countries cannot be measured, assessed or estimated, they cannot provide the basic criterion of aid. An evaluation of national development effort—be it national or international—presupposes the existence of operational criteria which could be applied in practice to determine the amount of aid. Do such criteria exist and what are they? This is not the place to expound on and examine such criteria fully; that would require a separate study. Suffice it to say that, although approximate and subject to high margins of error and consequent zones of imprecision, such criteria do exist and can be applied to yield at least a ranking if not exact measurement of national efforts. Moreover, rough as they are, such criteria do not become any better if they are applied, or are said to be applied, by national instead of international agencies. The suspicion that they will not be functionally applied in bilateral relations is indeed all the greater because the criteria are rough and not easily grasped by non-professional public opinion. The very fact that only rough approximations rather than exact measurements of national effort are possible, far from being an argument against delegating such judgements, is an argument for an independent and multilateral evaluation.

33. A rough sketch of the main problems of evaluation may be preceded by three methodological remarks. First, economic theory can determine the necessary but not sufficient conditions of growth. The so-called " non-economic " factors account for the gap between the necessary and sufficient conditions. Any evaluation of development effort can only state that the necessary conditions for growth exist; it cannot predict with certainty that growth will actually take place. Secondly, most differences of opinion among economists originate from two sources: on the one hand, different interpretations of data, since data are mostly deficient; and, on the other different interpretations of or assumptions about objectives (ends), since the welfare function is seldom explicitly stated or even consistently understood. If both data and ends were given, there would be a large consensus as to how to apply economic techniques and few differences of opinion among economists would remain. Thirdly, planning objectives are determined by the society's scale of values (value judgements) incorporated in a " social welfare function ". These objectives relate not only to a rate of growth but also to income distribution and other social goals. The economist is no more competent to make these value judgements than any other citizen. The function of the economist, however, is to reveal and show explicitly the implications of policy decisions and also possible conflicts between various objectives. An international evaluation has to take the value judgements incorporated in the objectives of the national development programme as a datum.

34. It is necessary, first of all, that the evaluation should not fail to see the wood for the trees; it must assess the country's development effort and its strategy as a whole and not limit its attention to single project analysis. A collection of projects presented for financing does not add up to a programme, although any realistic programme should be specified in detail in projects. The various projects comprising a development programme are interrelated and reinforce each other. This balance depends on whether complementary activities have been planned on the required scale. It is therefore practically impossible to judge the soundness of any particular project without knowledge of the whole programme of which it is a part. The analysis and end-use supervision of projects can be undertaken as a sampling device to measure the execution of the programme and as a means of providing technical assistance in the preparation and selection of projects. These projects should of course satisfy the criteria of, on the one hand, additionality (i.e. they should represent additional investment) and, on the other hand, optimality.

35. Nor does investment consist only in what is normally described as projects, or even less as " bankable " projects. The necessary reorganization of the economy requires an effort in the area of fiscal, administrative and agrarian reform, progress in each of which is a part of a national effort and should be judged as the fulfilment of a project. The same is also true of a typically " non-bankable " project taking the form of the expenditure necessary for the reorganization of the economy in the sense of providing for the

diversification of exports. This is more easily said than done. The effort to switch from coffee, cocoa, bananas, sugar etc., to other exports must necessarily take several years. During the first, second and third year of such an effort no visible improvement in exports or yields appears on the surface. The reorganizing of exports is a project which has a gestation period of, say, five years when no increase in yield (there is even sometimes a fall in yield) will materialize during the first four years. Yet, unless this effort is undertaken when needed, the requisite diversification will not take place five years later. The investment necessary for projects of such long gestation requires external assistance. That, however, can be provided only within the context of a programme approach rather than within that of a single project approach.

36. There are, finally, two other reasons for a high proportion of programme-lending rather than project-lending. One is that a multiplicity of small projects does not lend itself to separate external loan negotiations, which can best be dealt with by national development banks that are given a separate block of loans for relending locally in small projects. More important is the situation where, for a certain period which may extend over one or two five-year plans or even longer, the foreign exchange gap is greater than the resources gap. A deficiency of foreign exchange leads to the frustration of some potential national savings. If more foreign exchange were available, more national savings could be realized. In the transition period, however, before the two gaps become equal through a proper reorganization of the economy (by increasing exports or intensifying import substitution), the amount of external lending required may be greater than the increase in national investment. Yet this is the only way of obtaining an increase in national investment after the transition period.

37. National effort can be measured only in relation to given objectives. The rate of growth of income alone is not the only objective. Even so far as the economic goal of growth is concerned, the criterion of maximum increase in income in any particular five- or ten-year period would not suffice. At different stages and different phases of development, more investment may be required to produce a unit of additional income than at others. This is invariably the case where, for instance, social overhead capital has to be built up first. Such investment in economic infrastructure yields directly only small increases in income. It creates, however, a framework necessary to the profitability of more immediately lucrative subsequent investments. The direct increase in income is less important here than the increase in investment opportunities. Income created per dollar of aid may, therefore, at first be low; far from being an argument for less aid, there are circumstances in which this might well be an argument for more.

38. The evaluation should assess a country's development effort as a whole, its absorptive capacity and its capacity to repay. According to the development potential and to the sufficiency or insufficiency of national effort, larger or smaller external resources might be recommended as a supplement to national effort.

39. "Absorptive capacity" consists of two components: first, the capacity to organize investment, i.e., the capacity to absorb capital (technical, or absorptive capacity in the narrower sense); secondly, the capacity to mobilize national savings for investment, best expressed by the level of and the extent by which the marginal rate of savings is higher than the average rate.

40. The capacity to organize investment, involving pre-investment studies, project preparation and execution, has its limits in every country. It can be stepped up in many developing countries—as has in fact occurred during the past decade—by nationally organized effort reinforced by technical assistance; there are, however, narrow limits to the pace and extent by which it can be expanded. If the rate of investment has been increasing in the past by, say, 5 to 6 per cent *per annum*, it might be raised by 25 to 35 per cent to, say, 7.5 to 8 per cent *per annum*. But it is not true to say that absorptive capacity depends entirely on the amount of effort one is willing to put into massive technical assistance. Outside skills and knowledge may well supplement but cannot entirely replace domestic abilities to organize and to administer. Education in the long run, and the transformation of habits in the short run, may widen the scope.

41. The capacity to mobilize savings can be stepped up more quickly, when savings are low, by institutional and fiscal reforms, notably by raising the difference between the average and marginal rate of savings; at average savings levels of 10 per cent of gross domestic product, the marginal rate could be twice or more than twice that high.[12] Judgement on a country's ability to mobilize additional taxes when incomes are rising may justify a projection far above the recently realized lower limit of the country's ability to save. A changing composition of output (more industry with high marginal rates of savings) will lead in many cases to foreseeably higher savings rates for the country as a whole.

42. While no exact measurement of absorptive capacity is possible, there is not in practice much difference of opinion about the "push" or "potential" of different countries; agreement can be obtained on a ranking order of magnitudes for a short period of the next few years. The longer the time distance, the less certain is the judgement; hence the need for periodical re-evaluations.

43. The flow of external resources should be within the limits, on the one hand, of absorptive capacity and, on the other hand, of the capacity to repay. While the first limit should preponderantly determine the amount of aid, the second should largely determine the method of financing it. The capacity to repay should not be assessed by a static projection of the present situation but should take into account the increase in income

[12] Of course, if higher savings cannot be readily converted into increased investment for want of an adequate supply of foreign exchange to finance the import content of higher investment, no useful purpose would be served by raising the rate of domestic savings. While in the short run increased national savings cannot replace foreign exchange, in the longer run such replacement becomes possible through a reorganization of the economy.

and the increase in the rate of savings—as well as expansion in the export-gaining and import-saving investments—which will result from the adoption of a soundly conceived development programme. Nor is it sensible to assume that the whole "hard" foreign debt of each country should be amortized within twenty or thirty years. The rational question is: how much foreign indebtedness can a country maintain in the long run? After, say, twenty years, the gross capital inflow may continue while the net capital inflow comes to a stop.

44. A development programme must be evaluated not only as to its consistency but also as to its feasibility. The question to be examined is not only what is to be done but also how it is to be done. A development strategy can use various mixes and combinations of the instruments of economic policy, i.e., of monetary, fiscal, foreign exchange and commercial policy. The task of an independent multilateral evaluation is not to prescribe one mix rather than another but to ensure that a purposeful combination of policies should add up to an efficient strategy of development. Governments are mostly more knowledgeable than independent experts as to which combination of policies is likely to be acceptable.

Chapter IV

Experience of multinational evaluation of development programmes

45. The main technical difficulty confronting the Committee of Nine in their evaluation reports was the fact that very few of the development programmes were well worked out and contained sufficient and reliable statistical documentation. The very process of evaluation, however, helped to identify the main deficiencies of the development programmes and was conductive to their better preparation in time. In many cases the evaluation reports had to be necessarily preliminary and confined to a general assessment of the appropriateness of the general strategy of development. In other cases (for instance, in those of Chile, Colombia and Venezuela), in spite of many lacunae the evaluation report could be more thorough. Direct discussions with high officials or ministers responsible for development policy decisions often succeeded in making both the national policy and the evaluation procedure of the *ad hoc* committee more consistent. It could thus to some extent modify and influence policy decisions and certainly also modify initial erroneous impressions about their content and rationale.

46. Foreign lending is an expression of national policy and is motivated by many factors, not all of which are related to the promotion of economic development. It might be better, however, if lending for purposes other than that of economic development were handled under a different name; nor would it obviously be the subject of an independent international evaluation. While the United States never failed to implement in practice the recommendations referring to aid in the reports of the Committee of Nine, it did so consistently on the stronger basis of its own evaluation in the form of a strictly bilateral negotiation. In spite of the goodwill shown by the United States Agency for International Development (USAID), the bilateral loan negotiations, even if they corresponded to the recommendations of the *ad hoc* committees, never stressed the principle that the conditions governing United States aid were limited to those contained in the independent and multilateral evaluation reports of the Committee of Nine. Moreover, in many cases in which aid was given without an evaluation report by the Committee of Nine, the amount and the conditions of loan contracts were no less favourable than those that were based on such reports. No wonder that gradually the impression spread in Latin America that the conditions insisted upon by the Committee of Nine were in many cases more onerous than those which could be obtained in a directly bilateral negotiation. The Alliance for Progress was not conceived as a perfectionist device. Even countries without development programmes or those which did not submit them to the Committee of Nine could not thereby be deprived of aid. But those which in fact submit their reports for evaluation and accept difficult and often painful decisions to implement the structural reforms postulated by the Alliance for Progress should receive more aid and more flexible conditions (for instance, the financing of local currency expenditure) than the others. Otherwise the positive inducement to do difficult things would tend to disappear; a moral obligation to implement the targets of the Charter of Punta del Este unfortunately does not in itself suffice. The United States in fact implemented the recommendations of the Committee of Nine evaluation reports, but never made it clear that those reports were the basis of its allocation. Gradually, therefore, after 1964, the evaluation reports of the Committee of Nine carried less weight than they had previously. The conclusion to be drawn from this experience is that, unless the recommendations of an independent international evaluation are known to provide the basis for aid policy, the evaluation cannot achieve its objective.

47. The country studies of CIAP, in its annual review of national development activities, were not generally understood to be a complement to the independent multilateral evaluations of the Committee of Nine and thus unintentionally created some confusion about and misunderstanding of the role of such reports. The procedure of this annual evaluation has two great advantages: first, that of constituting a continual progress report on the implementation of long-term plans; secondly, that of providing a platform for contact among all agencies involved in providing aid. Although none of these agencies assume any obligation or commitment, the meetings yield additional information and occasionally suggestions of a different approach to diagnosis and prognosis. Representatives of the country who are present and confronted with evaluation have, moreover, a clear impression that decisions are not taken behind their backs or without their being heard. The CIAP evaluation process also has disadvantages, however, if it is not supplemented by or based on independent multilateral evaluation reports. Discussions in the presence of all agencies and observers—which, moreover, also lead to a public *communiqué*—are necessarily inhibited from

probing too deeply and from raising difficult or embarrassing questions.

48. The evaluation procedure is necessarily a long process which involves not only a thorough study but also a series of discussions, suggestions and "*de facto* negotiations" with the Government concerning the tempo of structural reform and the acceleration of the national effort where possible. Such discussions are in practice impossible in a public hearing with all national and international agencies present. Nor can all the details of such discussions be aired publicly after they have taken place. The value of the evaluation report of an independent multilateral body such as the Committee of Nine does not consist primarily in its findings and conclusions but in the procedure of arriving at them by a series of discussions between the Government and the functional impartial body which does not represent either creditors or debtors. Such confidential discussions may enable an independent multilateral committee, such as the Committee of Nine, to understand the country's problem better and also enable the Government concerned to gain a better appreciation of the need for intensifying national effort. They will also make it clear that the recommended amount, continuity, and flexibility of aid will depend on what catalytic effect aid can be expected to produce in mobilizing additional national effort. However, the very nature of the committee's work was such that a vital part of its discussions and persuasion had to take place behind closed doors if it was to be fully useful.

Conclusion

49. This historical survey of the doctrine and practical experience of evaluation reports on national development efforts reveals the many difficulties involved in its application and the proximate reasons for slow progress in that field. It also shows, however, that without such an independent and multilateral evaluation principle, suspicions in aid negotiations will not be removed and a co-operative spirit and improvement in international relations will not be achieved.

50. At the same time, the experience of the Committee of Nine demonstrates that the institution of an independent international evaluation machinery cannot be fully effective unless the parties concerned are willing to accept the major implications inherent in the adoption of such a procedure.

51. What is said about the evaluation of a national development effort as a whole also largely applies to partial evaluations of a special aspect of economic and social development, for instance, the evaluation of conditions under which supplementary financing should be given in cases of declines in export earnings. The main problem, here again, is whether such evaluation conveys the assumption of being both multilateral and independent. IBRD, for instance, is a multilateral agency. There may be two main arguments against it being the ideal evaluation agency whose verdict should be accepted and followed by all the others. The first and less important is that it is ultimately governed by government representatives (executive directors) who vote according to the shares held by their Governments; in their great majority those are creditor and not debtor countries. This fact dilutes its independent character, but only formally, since in fact the management of IBRD is independent. The drawback is more in credibility than in content. The independence of the management may change in time, however, and may constitute a real weakness. A more serious drawback is the fact that the separation between programming and financing is lacking, since the same staff members of the Bank who evaluate the development effort also take part in loan negotiations, so that they are both judges and executors at the same time. That could be corrected by forming an independent subsidiary of international experts under their own statute and independent of IBRD, Economic survey mission of IBRD already frequently appoint heads of such missions from outside IBRD. The verdict of the mission has, however, to be accepted by IBRD. Institutional reform could correct that weakness in the future.

52. The International Monetary Fund is a multilateral agency but not an "independent" evaluator in that sense and only examines one sector or one aspect of development; it cannot undertake the role of general evaluation. It may provide short-term assistance in dealing with balance-of-payments difficulties, but it was not intended to be the agency which should give the green or red light for the allocation of aid.

53. Who, then, should do the evaluating and how are numerous overlapping multilateral evaluations to be avoided? The multiplicity of evaluating missions at present imposes an unbearable burden on developing countries and necessarily detracts from the efficiency of the evaluation reports. Some delegation of decisions to one, two or three—but not ten, twenty or thirty—evaluating bodies is undoubtedly called for. The perfectionist solution would be for such evaluations to be both independent and multilateral. Nationalist feelings prevailing at present in both developing and developed countries stand in the way of realizing this ideal. Will evaluations which are only partly independent without the real delegation of decisions to an arbitrating body be acceptable? That may be the second or third best solution, representing a step towards the final goal of a truly independent international court of economic justice—but that may be below the minimum threshold of credibility and therefore fail to fulfil its objects and function. The difference between a partly or wholly independent and partly or wholly multinational evaluation may be more than a difference of degree.

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The Alliance for Progress and multilateral economic co-operation

Paper prepared by the Inter-American Committee on the Alliance for Progress

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Chapter I

Background of the establishment of the Inter-American Committee on the Alliance for Progress

1. The establishment of the Inter-American Committee on the Alliance for Progress (CIAP) is closely linked to the history of the efforts made by the Latin American countries to provide a multilateral basis for the process of resolving the problems of economic and social development.

2. It is appropriate to recall—to refer only to the most recent experience—that, in seeking collective action, the Latin American countries went before the United Nations and obtained from the world body the creation of the Economic Commission for Latin America (ECLA). Those were the times when the Government of the United States believed that the problems of the Western Hemisphere countries were much less urgent than those which afflicted Europe and required " a type of collaboration in which a much greater role falls to private citizens and groups than is the case in a programme designed to aid European countries to recover from the destruction of war ".[1]

3. The Latin American countries had been insisting, since 1933, on the advisability of holding an inter-American economic conference that would provide the means of setting up a co-operative undertaking designed to achieve more rapid progress and which, at the same time, would constitute a tangible expression of solidarity based on a policital foundation.

4. It was, perhaps, due to these circumstances that the world body—rather than the regional one—became the first centre of multilateral action for stimulating the economic and social development of Latin American countries.

5. Under the direction of Mr. Prebisch, ECLA laid down the doctrinal framework for economic programming, industrialization, the interrelationship between trade and development, and regional economic integration. It may well be said that only then were the dramatic realities of Latin America's underdevelopment brought to the fore.

6. Up to 1957, the technical assistance programme established by the Truman Administration—better known as the Point Four Programme—and loans granted by the Export-Import Bank and the International Bank for Reconstruction and Development (IBRD) for specific projects, were the only developments worth mentioning in the area of inter-American economic solidarity, and it is appropriate in this respect to emphasize that their nature was clearly bilateral.

7. In 1958, the Government of Brazil outlined in " Operation Pan-America " the basis for collective action by the Western Hemisphere countries, the purposes of which were to adapt the international agencies and institutions to the requirements thrust upon them by the struggle against economic under-development; to broaden and bring up to date the resources of international financial agencies; to channel technical assistance toward higher productivity; to adopt urgent measures to stabilize commodity markets and guarantee economic development through a revision of the fiscal and economic policies of the individual countries. Operation Pan-America was defined as " a reorientation of continental policy ", not " a mere programme but an over-all policy ".[2]

8. Since then, the United States Government has been gradually moving towards a multilateral approach and a clearer perception of mutual dependence.

9. The signing, in April 1959, of the agreement establishing the Inter-American Development Bank (IDB), was another step in this process of bringing criteria closer together, and satisfied another old and justifiable Latin American aspiration, originally expressed seventy years earlier at the first International Conference of American States.

10. Operation Pan-America, designed to attack the problems of underdevelopment along a broad front, led to the establishment of a commission to study the formulation of new measures for economic co-operation (Committee of Twenty-one), agreed upon by the Council of the Organization of American States (OAS), and then by the Act of Bogotá, subscribed to in September 1960 by the third meeting of the Committee of Twenty-one. The Bogotá document, moreover, incorporates two

[1] Harry S. Truman, *Address at Petropolis Conference,* April 1947.

[2] " Operation Pan-America ", aide-mémoire presented by the Government of Brazil to the Governments of the Western Hemisphere countries in August 1958.

important features: it began the structural modification of the Inter-American Economic and Social Council in order to adapt it to the new and more intense activities expected as a result of deliberations and agreements reached during the aforementioned meeting, and for the first time the United States Government made a specific contribution to inter-American social development in the form of a social progress trust fund. Furthermore, progress was being made along the road to multilateral action, since it was provided that IDB should be " the chief mechanism responsible for managing this fund ". The process was becoming more vigorous and dynamic.

11. On 13 March 1961, President Kennedy, in a historic address, stated that " if the countries of Latin America are ready to do their part—and I am sure they are—then I believe the United States, for its part, should help provide resources of a scope and magnitude sufficient to make this bold development plan a success, just as we helped to provide, against nearly equal odds, the resources adequate to help rebuild the economies of Western Europe ". That joint undertaking, in which external aid would supplement the self-help efforts of each Latin American country, was designated by President Kennedy as an " Alliance for Progress ".

12. The Charter of Punta del Este signed on 17 August 1961, institutionalized the Alliance for Progress, which in turn embodied the ideas and aspirations conceived and sustained over many long years by the countries of Latin America.

13. The philosophy governing the Alliance programme is directed not only to increasing the growth rate of Latin American countries, but also to improving their social contours in a democratic system. While working on achievements of a strictly economic nature, the Alliance simultaneously contemplates the implementation of a series of reforms in the prevailing regional economic and social structures. There can be little doubt that this conception of the problem has been influenced by the historical experience derived from the application of programmes designed strictly for economic development in countries where social conditions are notably unjust and where only through totalitarian means has it been possible to emphasize economic development without fulfilling simultaneously urgent social needs.

14. The efforts being made by the Alliance for Progress are governed by reciprocal agreements of a multilateral nature. This means a substantial modification of the bases on which inter-American economic co-operation rested prior to the Act of Bogotá and the Charter of Punta del Este.

15. The Charter of Punta del Este set forth the following as underlying objectives of the Alliance for Progress: an increase in the rate of economic growth to a yearly level of at least 2½ per cent per capita; a more equitable distribution of national income; the diversification of economic structures, particularly through industrialization; a considerable increase in agricultural productivity and output, through comprehensive programmes of agrarian reform and improved storage, transportation and distribution services; the broadening of resources from the external sector of national economies by maintaining stable prices for commodity exports; developing programmes to avoid excessive fluctuation in foreign exchange incomes derived from exports; strengthening economic integration agreements in order to arrive at a Latin American common market; and adopting broad programmes in the fields of health, education and housing.

16. In order to achieve these goals, the member countries of the Alliance for Progress established certain basic requirements, among them: implementation of national economic and social development programmes for the purpose of reaching a self-sufficient level of growth; setting up such plans on the principle of self-help, as established in the Act of Bogotá, and maximum utilization of domestic efforts; strengthening and improvement of institutions, in both the public and private sectors, and including labour organizations, co-operatives, and business, industrial and financial entities, to enable them to make increasing and more effective use of national resources; and promotion and strengthening, through alliance programmes, of Latin America's movement towards economic integration.

17. To back up the national development programmes thus envisaged and implemented, the Charter of Punta del Este determined that the Latin American countries should have available a capital contribution from all external sources, during the first decade of operation, of not less than $20 billion, most of which would be provided by public funds.

18. There were, at Punta del Este, no fundamental differences as to the objectives sought by the Alliance. It has already been pointed out that those objectives incorporated a philosophy long felt and nourished by the Latin American countries, to which the United States would now add its support. It was, however, necessary to find a formula that would permit an " evaluation " of national development plans, and thus provide them with international financing. The United States sought to promote a greater collective responsibility in that area and therefore supported the idea of establishing an international agency to carry out the important " evaluating " function. Other countries shared the idea but at the same time felt that the evaluating body should have the power to approve the distribution of funds. According to an authoritative United States observer, John C. Dreier, the result of that impasse was the creation of the panel of nine experts, the powers of which were hedged about with various nationalistically inspired limitations.

19. Obviously, as recognized in a number of studies and publications, including the reports of the panel of experts, the compromise made in Punta del Este meant that the alliance was left with a power vacuum with regard to its administration, to the evaluating function and to the distribution of external aid funds.

20. Thus the Charter of Punta del Este entrusted the task of evaluating national development programmes to *ad hoc* comittees in which the panel members would participate together with experts designated by the Secretary-General of OAS, at the request and with the consent of the governments involved. The need for

having a body responsible for the multilateral representation of the Alliance and for the promotion, implementation and co-ordination of its programmes soon became evident.

21. In their report to the second annual meeting of the Inter-American Economic and Social Council (IA-ECOSOC) at the ministerial level, the panel of experts suggested the creation of a mechanism through which the activities of the organs of the Inter-American system having responsibilities in the development of the hemisphere and in the alliance programme, might be ascertained, linked together and co-ordinated, and sustained that the intention was to create an active mechanism with sufficient authority to make decisions in some cases and, in others, to co-ordinate, but in all cases to exercise specific executive functions, in order to accelerate the alliance programme. The panel, for the sake of even greater clarity, stated that IA-ECOSOC at the ministerial level would be the annual assembly having the highest decision-making powers in the technical field and in the administrative sphere, and would formulate the general policies, and that CIAP should act as its permanent agent to apply the policy determined by the IA-ECOSOC with regard to the alliance and to represent the alliance during those periods in which the latter body was not assembled.

22. If the matter was indeed urgent with respect to the Alliance itself, it was no less urgent that the adoption of the Charter of Punta del Este required the beginning of a revision of the whole Inter-American system, in view of the fact that the system, as constituted, had been in the main established prior to the Alliance for Progress, and in consequence might not possess a type of structure permitting of the achievement of the objectives of the Charter of Punta del Este in the dynamic and efficient manner required.[3]

23. On 20 November 1962, the Council of OAS, on the basis of the above considerations, resolved to request former presidents Alberto Lleras Camargo, of Colombia, and Juscelino Kubitschek, of Brazil, to study the organization and activities of the institutions and agencies of the Inter-American system with responsibilities in connexion with the Alliance for Progress, in order to recommend, if necessary, the procedural and structural changes indispensable to ensure the effectiveness and vigour of the Alliance.

24. The two Latin American leaders delivered individual reports and agreed that there was a need which could no longer be deferred for the creation of a permanent body to implement the programme of the Alliance for Progress.

25. Mr. Kubitschek conceived the body as a permanent, collective agency, capable of fixing guidelines within the sphere of execution of the Alliance and of exercising functions that would impart to common undertakings the energy and efficiency they now lacked. Under the policies established by the Inter-American Economic and Social Council at the ministerial level —that is, by the Governments of the member States— the new agency should represent common interests and show impartiality, and its decisions should be of a multilateral nature, in the spirit of the Charter of Punta del Este. The agency should be an organ of the Inter-American Economic and Social Council, permanently occupied with the deliberations and decisions necessary to the energetic and effective execution of the Alliance for Progress.

26. In the opinion of Mr. Lleras Camargo, the agency, assisted by a high-level advisory board, would be responsible for making arrangements with the United States Government, the Inter-American Development Bank, the Export-Import Bank, IBRD, the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD), the European countries and Japan, individually or collectively, and with private banks etc. for financing national programmes. Furthermore, it would ensure the equitable distribution of funds that might be anticipated at any time for the proper financing of national programmes. In each country, it would encourage the government or private enterprise to act as rapidly and efficiently as possible in putting the programmes into effect, and it would take note of any default in national or foreign contributions offered for developing each national plan, as well as of delay in or compliance with the aims established therein, in order that further stages might be adapted to the likelihood of achieving those aims.

27. The high-level advisory board referred to would be the panel of experts, which, according to Mr. Lleras Camargo, should be transferred into an active body, in the nature of a technical advisor, designed essentially to evaluate national programmes. Its duty, however, he added, should certainly not be limited to providing experts for studying the programmes; it must review the programmes once they had been prepared by the *ad hoc* committees, for the purpose of establishing the greatest possible consistency of criteria, and advise, in the main, on the potential for economic integration that might arise from the individual plans. It would likewise serve as the consultative body of the proposed Inter-American Development Committee (later CIAP).

28. As will be seen, those ideas have been largely accepted in the process of transforming the organs of the Alliance for Progress.

Chapter II

Establishment of the Inter-American Committee on the Alliance for Progress (CIAP)

29. Based on the coinciding viewpoint of the two former presidents, the second meeting of the IA-ECOSOC at the ministerial level, held in São Paulo, Brazil, in November 1963, adopted resolution 1-M/63 creating the Inter-American Committee on the Alliance for Progress (CIAP).

30. The resolution afforded an institutional framework adequate to the Alliance that was, nevertheless, flexible enough to be adapted—both structurally and opera-

[3] Resolution A-8, adopted at the first meeting of the Inter-American Economic and Social Council at the ministerial level.

tionally—to the conditions and requirements of an undertaking called upon to face problems of enormous magnitude. Furthermore, there were no precedents or experiences of multilateral action to guide the Alliance and its committee, with the exception of certain aspects of the implementation of the Marshall Plan, duly adapted to the differing circumstances of the problem to be faced. In the case of Europe, the task had been to rebuild economic structures destroyed in the Second World War. In that of Latin America, it involved overhauling an entire organism, long affected by the chronic illness of underdevelopment. Europe prior to the Marshall Plan had had available a number of valuable resources of its own with which to begin the process of economic and social reconstruction. It had had vast transportation and communications networks which, though seriously damaged, could be rebuilt, and its population had possessed a high level of literacy, know-how and technical skills.

31. As far as the Alliance for Progress is concerned, the process of broadening multilateral action is clearly accelerating.

32. The Act of Bogotá, of October 1960, set forth a number of recommendations for the establishment of " multilateral co-operation for economic and social progress ", consisting, fundamentally, of annual meetings of IA-ECOSOC in order to review the economic and social progress of the member countries, to analyse the advances made and the problems met in each case and to prepare reports on prospects for the future.

33. A few months later, the Charter of Punta del Este introduced the concept of preparing national development programmes to be submitted to the consideration of an *ad hoc* committee made up of members of the panel of experts and technicians appointed in accordance with proposals by the interested Governments. " The recommendations of the *ad hoc* committee "—as stated in the Charter of Punta del Este—" will be of great importance in determining the distribution of public funds under the Alliance for Progress which contribute to the external financing of such programmes. "

34. As already mentioned, in November 1963, the second annual meeting of IA-ECOSOC at the ministerial level established CIAP and gave that body the task of conducting analyses of national development efforts which came to be a regular system of annual " country reviews ".

Chapter III

The concept of multilateralism

35. The Alliance for Progress is the first truly multilateral economic co-operation effort. It is based on a formal compact among countries, including donors and recipients, in which all assume reciprocal obligations. In this sense, the alliance differs from the Marshall Plan, under which there existed no formal multilateral treaty or agreement, but only a unilateral statement of policy by the United States. While the recipient countries organized themselves multilaterally, through the Organization for European Economic Co-operation (OEEC), in order to facilitate the distribution of assistance, the United States, as the donor country, was not formally bound by any of its decisions or recommendations although in practice it adhered to them. Unlike the Marshall Plan, therefore, the Alliance for Progress constitutes a multilateral agreement set forth in the Charter of Punta del Este and signed by all member countries, including the United States. Thus the Alliance is not a United States aid programme; it is a truly inter-American effort, based on the principle of multilateralism. Because of these characteristics of the Alliance, moreover, its direction must also be multilateral. Thus the question whether the signatories of the Charter of Punta del Este comply with their commitments obviously cannot be left to the decision of one or a few countries, as might have been possible under the Marshall Plan. It must be based on collective decision.

36. As noted earlier, this multilateral concept has been taking shape within the Inter-American system for nearly a decade. What is important in this respect is not so much the way the financial or technical aid is channelled, but rather whether its amounts, conditions, distribution, and the tests of internal performance are determined by a body in which donors and recipients are represented. This is not a purely technical exercise. It is essentially a policital one, although it requires a sound technical base. In this sense it should be stressed that there is a considerable difference between the evaluation of a development plan as such—the task with which the panel of experts is charged—and the evaluation of a development policy. While those concepts are different, they are complementary. The multilateral direction of the Alliance, pinned exclusively on plan evaluation alone, could be as inadequate as if its management were based purely on an analysis of short-term policies and performance, and on the obtaining of financing. In order to evaluate performance and policies, there must be a plan or strategy having a multi-annual time dimension.

37. Secondly, such evaluations must be linked to financing. The technical evaluation of a plan in and by itself does not, under present conditions, automatically generate the required financing. Although it is to be hoped that the mechanism of internal economic co-operation can some day be carried to the point at which a technical body, by virtue of its prestige and independent judgement of a development plan, would automatically oblige all sources of external financing to furnish the required capital and technical assistance, such a situation today may still be premature. Thus an organ like CIAP is required to analyse policies and performance and to play active roles in securing external assistance, based on internal effort. In this sense, the establishment of CIAP constitutes the completion of the multilateral apparatus of the Alliance, which began with the restructuring of the IA-ECOSOC and the creation of the panel of experts. The panel of experts and CIAP, together, represent the practical machinery required to give multilateral direction, supervision and co-ordination to the Alliance for Progress.

Chapter IV

CIAP functions and the country review process

38. CIAP is not a judicial body. It is more like an international ombudsman, representing the interests of the developing countries before the external financial community and *vice versa*. The prime function of CIAP is to determine each country's internal performance and external financial needs, and on that basis to calculate for the region as a whole and for each member financial availabilities and requirements, as well as their distribution. In addition, CIAP is charged with the study of other "horizontal" problems of the regions, with a view to making appropriate recommendations on such matters as inflation, external debt burden, private investment, trade and agrarian reform. CIAP's functions are fundamentally those of evaluating internal effort and making recommendations on supplementary external financial assistance requirements; acting on behalf of recipient countries in obtaining financing; making representations with individual countries regarding their commitments, particularly those relating to internal reforms as well as to trade policies prejudicial to the interest of Latin America; promoting the co-ordination of assistance among financial agencies, and representing the Alliance for Progress multilaterally.

39. Those functions are carried out through a system of annual country reviews, each lasting about one week, with the participation of individual country delegations, representatives of the international financial community (IDB, IBRD, the United States Agency for International Development (USAID), the International Monetary Fund (IMF)) as well as of several United Nations organs (the Economic Commission for Latin America (ECLA), the United Nations Development Programme (UNDP), the International Labour Organisation (ILO), the Food and Agriculture Organization of the United Nations (FAO)) and observers from non-member donor countries (Belgium, Canada, Federal Republic of Germany, Israel, Italy, Netherlands, Spain, Switzerland and the United Kingdom.

40. These "country reviews" are preceded by staff visits and consultations with each country and with the external financial agencies prior to the session, which serve as a basis for the working paper presented in each case. Moreover, the panel of experts has completed an over-all plan evaluation, which is used as the framework for assessing performance and needs. At the end of each review, a set of specific conclusions and recommendations pertaining to the entire breadth of the development effort is worked out, including quantitative targets for internal resource mobilization.

41. As a follow-up to these reviews, it has now become customary to request countries to file reports concerning implementation of recommended measures or to supply new data, as well as to obtain information from the financing agencies regarding the extent to which they are meeting the capital requirements. In some cases, letters outlining intended policies and measures, in accordance with the recommendations of CIAP, are filed with the Chairman of CIAP.

42. This review is multilateral to the extent that it is conducted by CIAP sub-committees and presided over by a CIAP member. It is multilateral to the extent also that the technical work is prepared by an international secretariat or by the panel of experts, which is also multinational in character. The multilateral aspect is further strengthened by the active participation of other multilateral agencies, particularly organs of the United Nations. As a result, purely bilateral considerations, that might operate against the interests of genuine development, are pushed into the background.

43. Apart from the foregoing, these reviews have other important effects. First, they permit each country to set forth its policies and to justify them before a full forum of countries and financial agencies. Until the creation of CIAP, no such forum existed. Secondly, the preparations made for such reviews by each individual country have been an important factor in the better co-ordination of policies, the preparation of statistics, and the stimulation of public interest in the development effort. Thirdly, the sessions make it possible, for the first time, for each financing agency or country to obtain a more systematic knowledge of the position and policies of the others. Often, this leads some agencies to alter their position in the light of the position of others. Fourthly, to the extent that the reviews cover the broad economic and social panorama, individual country or agency participants obtain a view that goes beyond immediate project considerations and shows the broad relationships and their impact on a particular programme. Thus, for example, IMF is made aware of certain social or non-financial considerations, whereas another agency, such as ILO or FAO, may be informed about fiscal problems and their impact on manpower or agricultural programmes. Fifthly, observers from non-member countries are able to learn about possibilities for their financial or technical contribution. Lastly, moreover, the review attempts to arrive at a broad consensus of priorities.

44. From the beginning, the panel of experts participated in such reviews. During its first plenary meeting after its creation, CIAP considered that the possibility of making relatively exact assessments of domestic efforts and external resource requirements existed only in the case of those countries whose plans had been evaluated by the panel of nine experts. In addition, CIAP decided that members of the panel would participate in the sub-committees entrusted with carrying out the country reviews.

45. No process in the Alliance for Progress has made a more fundamental contribution to the efficacious multilateralization of Latin America's economic and social development efforts than the country reviews conducted annually by CIAP. It is noteworthy that the country reviews have the participation of international financial agencies and institutions, extracontinental countries and Canada.

46. This constituted the materialization of the aspiration expressed by the panel of experts in suggesting the creation of a permanent forum to debate and review the problems and policies of the Alliance, with the collective participation of the countries of Latin Amercia and the

United States, and even financial agencies and capital-exporting countries, in order that such policies and problems might not be defined and interpreted unilaterally.[4]

47. Michael L. Hoffman pointed out in June 1966 that the pattern of co-ordination which was being developed by CIAP was that the Latin American countries subjected their policies and programmes to high-level international review, while the United States subjected its aid programmes and economic policies towards Latin America to review by the same body. The composition of CIAP, the way it conducted its meetings and the sense of permanence about it, compared with previous co-ordination efforts, had combined to raise it very quickly to a position of authority held by no other intergovernmental committee linking sources of aid and recipients. Mr. Hoffmann had selected for comment only one aspect of the CIAP experience which seemed to him especially significant in its implication for the problems of aid co-ordination in other parts of the world and in other frames of reference, namely, the extent to which CIAP had been able to gain acceptance of the idea that it was neither an infringement of sovereignty nor a confession of weakness for a Government to submit its economic development plans and policies to examination by its peers assembled in committee. The extent to which the country review exercises of CIAP were developing into serious and objective critiques of national economic performance did not seem to be widely recognized outside circles directly involved in Western Hemisphere affairs. Only in OECD was any similar collective review of national performance regularly carried out, and the circumstances there were different, although it was worth recalling that the OECD practice had originated at a time when many of the then members of the Organization for European Economic Co-operation (OEEC) had also been aid recipients. CIAP worked in private and had developed procedures that emphasized the mutuality of the review process. As a result of its operations, it seemed to be increasingly accepted in Latin America, more than in any other part of the world, that performance commitments by a Government to an impartial international body were not merely an appropriate, but in fact an essential part of a rational and mutually beneficial relationship between Governments and agencies which were sources of development finance, and recipient countries. The International Bank for Reconstruction and Development and the International Monetary Fund had, of course, for years sought and sometimes obtained performance commitments based on recognition by a country that its long-run interest would be thereby served. CIAP's great contribution in that area was the simultaneous recognition by aid sources and recipient countries that not merely one or two countries and not merely badly performing countries, but all developing countries could benefit from objective reviews of economic performance and regular discussions in an international forum. The standing of the country whose programme was being examined was that of a member, not a petitioner. It was to be hoped that other regions, in which there was much talk but little evidence of a desire for regional co-operation of various kinds, would not wait as long or suffer as many frustrations as the countries of the Western Hemisphere before undertaking the kind of commitments to each other that were involved in the establishment and operation of CIAP.

Chapter V

Amendments to the Punta del Este Charter and further advances towards multilateralism

48. In March 1966 IA-ECOSOC, assembled in Buenos Aires, resolved to incorporate into the Alliance Charter a number of provisions designed to bring the charter into line with the evolutionary process that had been developed. Thus, as a result of the establishment of CIAP, the membership of the panel of experts —previously attached to IA-ECOSOC—was to be composed of up to five high-level technical experts attached to CIAP, which is, in addition, the permanent executive committee of IA-ECOSOC.

49. The modifications introduced into the Charter of the Alliance for Progress at Buenos Aires did not represent any change in the basic principle that national and international efforts towards the hemisphere's economic and social development should be evaluated in acordance with functional criteria by an independent organ.

50. The panel members, who are selected from among the most experienced, competent and capable personalities available within the Inter-American system in the various and complex areas of development, maintain the same unchallenged autonomy in their judgements, evaluations and recommendations that have given meaning and authority to the actions of the past six years.

51. National and international development efforts are weighed according to functional criteria and by an independent body. The function which the Charter of Punta del Este originally limited to the *ad hoc* committees is now entrusted—as a task of the highest priority—to the panel. The designation of the *ad hoc* committees is now only an exception to the general rule.[5]

52. Another event of major importance has strengthened the multilateral and co-operative nature of the Alliance for Progress. This was the decision adopted by the United States to grant Alliance programme loans in accordance with the conclusions and recommendations made by CIAP in its annual reviews of national development activities.[6]

53. This concept was broadened by the declaration of the presidents of America (14 April, 1967) at the meeting of American chiefs of State in Punta del Este and by IA-ECOSOC at its annual meeting in Viña del Mar, in order to include the financial institutions in general. At the January 1968 session of CIAP,

[4] Report of the panel of experts to IA-ECOSOC, 1963.

[5] Resolution 27-M/66, adopted by IA-ECOSOC, Buenos Aires.

[6] Foreign Aid law, Fulbright amendment.

moreover, the programme lending policy of the United States to Latin America was linked to the CIAP country reviews, with respect to timing and criteria.

54. In view of these advances towards genuine multilateralism, the need for effective and objective criteria for assessing performance by the recipient countries and donors becomes ever more pressing. The problem centres around the establishment of a series of standards and indices, both qualitative and quantitative, against which development—as distinct from simple aggregate economic growth—can be measured. CIAP is now in the process of developing such criteria, based on a specific mandate by IA-ECOSOC. Once such indices are established it will be possible to reduce even further some of the subjective considerations that still govern some aspects of international economic co-operation, and to set up an adequate technical basis for multilateralism that will be fully attuned to the institutional advances achieved so far.

55. There is no doubt that the concept of multilateral economic co-operation is the trend of the future. The significant advances achieved within the Inter-American system and the lessons learned, especially regarding the institutional aspects, may well be applied to other developing regions as well. The advantage of CIAP and the panel of experts is precisely that they are not financial institutions and that the criteria they are able to apply to the development effort of each country can be broad and flexible and can go beyond a purely sectoral project or approach, so as to include the all-important human and non-economic determinants of the development strategy. Nor is it possible for these organs to use the pressure of financial resources in particular situations, thereby safeguarding the sovereign rights of each nation to shape its destiny in accordance with its own traditions and institutions. There is need, however, for further advance towards the concept of " global plan financing ". This will require joint efforts by several donors and financial agencies, through the consortium idea. For this concept to develop further, however, there is need for a " residual lender ", i. e., an agency or institution that will finance those projects or programmes which, while necessary and rational, are not of a nature able to be accepted by the financial institutions. To search for such a lender will have to be a task of CIAP for the future.

SUPPLEMENTARY FINANCIAL MEASURES

DOCUMENT TD/41

Joint statement by the developing countries members of the Intergovernmental Group on Supplementary Financing*

[Original text: English]
[16 November 1967]

1. The efforts of developing countries to accelerate the pace of their economic development are severely hampered by uncertainty regarding their export earnings. In view of the crucial importance of foreign exchange in economic development, uncertainty regarding foreign exchange receipts renders orderly planning extremely difficult. Export earnings usually being the most important source of foreign exchange, unexpected export shortfalls can seriously disrupt otherwise sound development programmes. The developing countries therefore wish to reaffirm their strong support of recommendation A.IV.18 of the first session of UNCTAD[1] and wish to state that in their view a scheme along the lines of that recommendation is both desirable and feasible.

2. The developing countries note that, in its study[2] the staff of the International Bank for Reconstruction and Development (IBRD) came to the conclusion that the problem of adverse movements in the export proceeds of developing countries was a genuine one, because of the disruptive effect on development; that the existing international financial machinery did not include a mechanism designed to meet the problem; and that a feasible scheme of supplementary financing could be worked out. The developing countries strongly support this view, and note also that it has received the support of several developed countries.

3. The scheme should embody the following elements:

(a) An export norm from which shortfalls may be measured;

(b) A policy understanding;

(c) Provision for the use of other available resources;

(d) Clearly limited financial commitments by donor countries to a fixed and adequate amount, such amount to be additional to that which donor countries are now providing by way of development assistance;

(e) Compatibility with the compensatory financing facility of the International Monetary Fund (IMF).

4. It is indispensable for assistance under the scheme to be based on objective criteria. There is a general agreement in the Intergovernmental Group on Supplementary Financing on the need for an export norm of some kind. The IBRD staff has proposed that the export norm be determined by export projections, and the developing countries support this approach as the appropriate method for interpreting "reasonable expectations". It may be noted that the drawing up of any development plan necessarily involves taking a view of export prospects, and under prevailing international practice the need for basic development finance is determined at least in part on the basis of prospective export receipts and foreign exchange expenditure. What the scheme implies is that, in so far as export receipts fall short of the level foreseen in the development plan, as accepted by the international community, efforts should be made to make good the shortfall, so as to permit the accepted plan to be implemented.

5. The developing countries accept the view that it is necessary to ensure that supplementary finance is used for the purpose for which it is intended, namely, to safeguard development plans against disruption due to export shortfalls that are beyond their control. To this end, they agree that countries should, at the beginning of each planning period, have a policy understanding with the administering agency indicating the main lines of the economic policy that they intend to pursue. In addition, at the time of any shortfall, there should be a determination, by consultation between the agency and the country concerned, of whether the drop in export income is due to circumstances beyond the control of the country concerned.

6. It has been suggested in the IBRD staff study that consultation between the agency and member countries should take place on a continuous basis so as to ensure a prompt determination in the event of a shortfall. The need for such continuous consultation requires further examination. In any event, consultation under the scheme, whether continuous or whether limited along the

* Statement submitted on 11 November 1967 during the group's third session. The developing countries members of the group are: Argentina, Brazil, Ceylon, Ghana, India, United Arab Republic, Yugoslavia.

[1] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I: *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 52.

[2] See IBRD, *Supplementary Financial Measures* (Washington, D.C., 1965). For a discussion of the study, see United Nations publication, Sales No.: 68.II.D.3, paras. 18-98.

lines of paragraph 5, would have to be consistent with the requirements of national sovereignty as defined by the country concerned.

7. The IBRD staff report recommends the prior use of other foreign exchange resources, including reserves and the compensatory financing facility of IMF, if available. The developing countries accept this proposal. At the same time, they wish to point out that countries suffering export shortfalls should not be compelled to resort to credit facilities which are subject to onerous terms and conditions, or to run down their gold and foreign exchange reserves below prudent levels.

8. The working out of a supplementary financing scheme should not interfere with International Development Association replenishment, since financial obligations under the scheme could not arise for some considerable time ahead.

9. The developing countries fully endorse the view that the scheme must not be established in such a way as to give rise to an open-ended commitment on the part of donor countries. They are satisfied that a workable scheme could be set up on the basis of a fixed commitment of \$300 to \$400 million per annum for an initial five-year period as recommended by the IBRD staff. The developing countries accept the need for rationing as a method of last resort for reconciling claims upon the agency with fixed resources. They are convinced that it is feasible to establish an equitable system of rationing on objective criteria.

10. The developing countries see the need for further liberalization of IMF's compensatory financing facility, but they believe that the objectives of the supplementary financing scheme cannot be secured through such liberalization. Nor can they accept refinancing of the IMF facility as the sole or main objective of the scheme.

11. On the other hand, the developing countries accept the view that the operations of the agency should be compatible with those of IMF. This should be secured by consultation between the two institutions, bearing in mind the views of IMF on matters falling within its competance, such as the extent to which there should be recourse to the gold and foreign exchange reserves of member countries in meeting export shortfalls.

DOCUMENT TD/II/C.3/2

The role of supplementary financial measures in the development of an international commodity policy
Note by the Secretary-General of UNCTAD

[Original text: English]
[1 March 1968]

1. A basic objective of an effective international commodity policy is to tackle the problems created, on the one hand, by the relatively slow rate of growth of commodity exports of developing countries and, on the other hand, the instability and uncertainty which characterize this segment of world trade.

2. Given the complexity of factors influencing the commodity outlook, an effective international commodity policy should provide for a multi-dimensional but well co-ordinated programme of action. In the final analysis, the basic long-term solution to the problems of sluggish growth, instability and uncertainty of commodity exports must be found in a progressive diversification of the structure of production and exports in developing countries. It has been recognized, however, that progress towards diversification is bound to be slow and that direct measures are needed to deal with the instability and uncertainty of export earnings. It is for this reason that the Final Act of the first session of UNCTAD laid considerable emphasis on action designed to deal with the specific problems of instability and uncertainty of exports as an essential element of an integrated international commodity policy.

3. Two complementary approaches to this problem are needed. On the one hand, efforts should be made, to the maximum extent possible, to secure international commodity arrangements which would " stimulate a dynamic and steady growth and ensure reasonable predictability in the real export earnings of developing countries, so as to provide them with expanding resources for their economic and social development, while taking into account the interests of consumers in importing countries ".[1] On the other hand, in view of the fact that such arrangements may prove difficult to achieve for certain types of commodities, and that they could not in any case ensure the complete elimination of all fluctuations in export earnings of developing countries, there is a need for additional measures which would provide assistance to countries encountering such fluctuations through no fault of their own.

4. The fact that international commodity arrangements cannot entirely eliminate fluctuations in export earnings will be apparent for several reasons. In the first place, not all primary commodities readily lend themselves to stabilization arrangements. For example, there are difficulties in devising arrangements for commodities that are perishable, or which are subject to competition from comparable products or synthetics produced in the industrial countries.

5. Where commodity arrangements are feasible, provision is usually made for floor and ceiling prices within which price fluctuations are permitted. For example, in the proposed international cocoa agreement, a price range of from 20 to 29 cents per lb has been envisaged. This means that prices may still fluctuate by up to 45 per cent of the floor price and the export earnings of countries could be affected accordingly. Moreover, even if prices remain stable, the export earnings of particular countries can be affected by such factors as crop failures affecting the volume of exportable output.

6. Even the most effective programme of international commodity arrangements, or organization of markets, that can be envisaged would therefore not eliminate completely the danger of disruption of development programmes due to export shortfalls outside the control of the countries concerned. It would be the object of a supplementary financing scheme to seek to deal with the residual problem of export shortfalls that had not been avoided through whatever commodity arrangements existed.

7. It is important to note, from the point of view of donor countries, that the resources required for a supplementary financing scheme do not involve duplication with those required for commodity stabilization. This follows from the fact that supplementary financing is residual financing. The more efficient are the international commodity arrangements in preventing price fluctuations, the less would be the resources required for supplementary financing. The two types of scheme are therefore, in a very real sense, complementary and not competitive.

8. This point may be further illustrated by reference to certain regional arrangements currently in force which seek to deal with commodity price fluctuations. The European Economic Community (EEC) has an arrangement whereby Associated African States and Madagascar as well as overseas countries and territories receive deficiency payments in respect of certain fats and oils exported to EEC whenever market prices of these fats and oils fall below a reference price. Under the scheme presently in force, the amount of payment due is calculated on the basis of 80 per cent of the difference

[1] *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 26.

between the reference price and the world market price of each commodity, multiplied by the quantity of the respective commodity imported by EEC from the countries concerned. Although this system has obvious advantages for the latter countries, they could still encounter some difficulties. For one thing, it is quite natural that no compensation is provided in respect of exports to non-EEC countries. Moreover, as noted above, compensation is paid only on the basis of 80 per cent of the difference between the reference price and the world market price ; and the reference price itself can be modified through normal EEC procedures after the first year of operation of the scheme. In the third place, stable prices cannot prevent a loss of export earnings if, for any reason, there is a decline in the quantity exported. And finally a limit[2] is placed on the total sums payable under the scheme, so that if actual claims were to exceed that limit, the amount of assistance provided to each country would be reduced proportionally. Supplementary financing can help to fill some of these gaps. Since supplementary finance is a residual source of finance, there should be no conflict between it and the existing EEC arrangements. In determining the amount of assistance needed, the agency administering the scheme for supplementary financing would take account of the assistance available under the EEC system.

9. Similar considerations arise in relation to the Commonwealth Sugar Agreement, which assists in stabilizing the export earnings of Commonwealth producers of sugar. The United States quota system for sugar has a comparable effect in respect of countries granted preferential access to the United States market. However, countries with export surpluses in excess of those which can be disposed of in preferential markets at pre-agreed prices have to sell them on the free market, which is subject to chronic instability. In so far as exporters of sugar to the United Kingdom and the United States nevertheless suffer from export instability, the existence of a scheme for supplementary financing would help to offset the adverse effects of the residual element of export instability.

10. In general, therefore, the negotiation of commodity agreements or of the organization of markets, would not eliminate the need for a scheme of residual finance in cases where the stabilization programmes concerned were not fully effective in preventing unexpected export shortfalls. But they would reduce the cost of the scheme by limiting the frequency and magnitude of such shortfalls. The two types of scheme would thus mutually support and reinforce one another.

[2] The limit is 13 million units of account for the period from 1 July 1967 to 31 May 1969.

11. The proposal of the staff of the International Bank for Reconstruction and Development (IBRD) on supplementary financing[3] anticipates an initial expenditure of $300 to $400 million per annum for the purposes described above. The assumption is that this amount of resources would be additional to the bilateral and multilateral assistance currently provided through other channels. It is thus envisaged that subscriptions to the supplementary financing agency would not be at the expense of other existing programmes of assistance, whether for commodity stabilization or for other purposes. There is, of course, always a sense in which resources used for one purpose cannot be used for another. Since funds contributed by donor countries for supplementary financing would presumably count towards the achievement of the 1 per cent target, it might be suggested that, granted the fulfilment of the target, there is a choice between allocating resources for supplementary financing as against allocating them for some other purpose. What could be said, however, is that the supplementary financing scheme envisaged would not compete for resources with other existing programmes of assistance ; but that as additional resources become available over and above present levels as donor countries move towards the achievement of the target, it might be reasonable to allocate $300 to $400 million per annum of these additional resources for supplementary financing.

12. Finally, there is the question whether the functions envisaged for a supplementary financing scheme could be fulfilled through the compensatory financing facility of the International Monetary Fund (IMF). Recommendation A.IV.18 of the first Conference[4] took specific account of the IMF facility, but recognized that this facility was not designed to deal with the objective of that recommendation, namely, the provision of assistance to help in avoiding the disruption of development programmes arising from adverse movements in export proceeds. Here again, however, no duplication is envisaged, since, as provided both in recommendation A.IV.18 and in the IBRD staff proposal, the amount of supplementary finance provided to any country would take into account any short-term accommodation received by that country from IMF under its facility. Provision is also made in the proposed scheme for continuous consultation and co-operation between IMF and the supplementary financing agency on all questions of joint concern.

[3] See IBRD, *Supplementary Financial Measures* (Washington, D.C., 1965).

[4] *Proceedings of the United Nations Conference on Trade and Development, op. cit.*, p. 47.

INTERNATIONAL MONETARY ISSUES

DOCUMENT TD/7/SUPP.7*

Progress report on international monetary reform
Note by the secretariat of UNCTAD

[Original text: English]
[2 November 1967]

Summary

1. It is now generally agreed that the present system of reserve creation based on the accretion of gold to monetary authorities and the balance-of-payments deficits of the reserve currency countries cannot be relied upon to bring about an orderly growth of reserves suited to the requirements of an expanding world economy.

2. The Executive Directors of the International Monetary Fund (IMF) have recently approved the outline of a facility for the creation of special drawing rights operated through a Special Drawing Account in IMF. At its September 1967 meeting at Rio de Janeiro, the Board of Governors of IMF requested the Executive Directors to submit by 31 March 1968 a report proposing amendments to the Articles of Agreement and the By-Laws of IMF so as to establish a new facility on the basis of the agreed outline. After approval by the Board of Governors, this document will be submitted to Governments for ratification.

3. Special drawing rights will be created under the new scheme for an initial basic period of five years. They will represent unconditional liquidity in the sense that a participant will be able to use them in the event of a balance-of-payments or reserve need without its judgement of need being subject to prior challenge. However, members will be expected not to use special drawing rights for the sole purpose of changing the composition of their reserves.

4. Like the existing practice in IMF, a member's choice of currencies to be drawn will not be unfettered but will be subject to guidance from IMF based on the following general principles: *(a)* normally, currencies will be acquired from participants having a sufficiently strong balance-of-payments and reserve position; *(b)* IMF will seek to bring about over time equality in the ratios of holdings of special drawing rights to total reserves of various participants.

5. Countries using their special drawing rights will be obliged to reconstitute them in accordance with agreed rules. The reconstitution rules for the first basic period of five years provide that reconstitution will be necessary if the average net use of special drawing rights by a participant, taking into account both use below and holdings above its net cumulative allocation, exceeds 70 per cent of its average net cumulative allocation during this period.

6. In order to enhance the acceptability of the special drawing rights as a reserve asset, they will carry a gold value guarantee and also a moderate rate of interest. Moreover, in order to protect the interests of individual participants, a participant's obligation to provide currency in exchange for special drawing rights ceases once its total holdings of these drawing rights are equal to three times its net cumulative allocation.

7. Participation in the new scheme will be open to all members of IMF that accept the obligations of the scheme. The distribution of special drawing rights to members will be expressed as a percentage of quotas, uniform for all members. A member's quota in IMF will be the same for the purpose of both the General and the Special Drawing Account of IMF.

8. The agreed outline does not deal with the conditions for the activation of the scheme and they are to be defined in the introductory section of the amendment and, to the extent necessary, in a report explaining the amendment to the Articles of Agreement and By-Laws now in preparation by the Executive Directors of IMF. In view of the growing evidence that an overall shortage of world reserves is contributing to restrictions on trade and aid policies in the developed countries, it would appear desirable that consideration of the activation of the scheme be begun as soon as possible, and not await ratification.

9. The agreed outline provides that decisions to create special drawing rights would be taken by an 85 per cent majority of the total voting power of all participants. This provision is stricter than the existing practice of IMF concerning major decisions and would confer special bargaining advantages on any group of countries able to muster more than 15 per cent of total votes. While the provision is designed to achieve the degree of consensus required for the effective operation of the scheme, there is a danger that in a situation calling for

* Incorporating document TD/7/Supp.7/Corr.1.

urgent action a stalemate between major voting groups could affect vitally the interests of small countries.

10. Now that agreement has been reached on the outline of a scheme for the creation of a new form of international monetary reserve, renewed consideration should be given to the implications of this decision for the flow of aid to the developing countries. Balance of payments difficulties have been cited by some of the main aid-giving countries as a major obstacle to the expansion of aid, and potential loss of reserves has been a factor affecting the policies even of surplus countries. In so far as the creation of new reserves eases the process of international balance of payments adjustment it creates a presumption that the flow of aid could be increased likewise. This would be true whether or not such an increase in the flow of aid were organically linked to the process of reserve creation. While there are important advantages in an organic link, the requirements of the situation could equally well be met if a convention were adopted whereby acts of international liquidity creation were accompanied by voluntary contributions to the International Development Association (IDA) by all the Part I Member countries of IDA—the size of the voluntary contribution being a certain uniform proportion of the share of each Part I country in international liquidity creation. By these means, it would be possible to secure generous replenishment for IDA from time to time without any fear that some countries might stand to lose reserves as a result of their contributions to IDA—a fear that has played a major part in the current delay in IDA replenishment.

11. The Executive Directors of IMF are reviewing the rules and practices governing IMF's traditional activities and they have been requested by the Governors to submit by 31 March 1968 a report proposing amendments to the Articles of Agreement and the By-Laws of IMF in order to give effect to modifications they will recommend. One of the proposals under consideration would involve raising to 85 per cent the voting majority required for certain major decisions in IMF. Concern has been expressed as to whether the requirement for a higher majority might render IMF policies governing drawings in the credit tranches more restrictive than they now are. Such a development, if it came about, would run counter to the widespread desire of developing countries for greater automaticity in ordinary drawings. Any revision of the present rules and practices of IMF should therefore take the wider interests of the entire world community into account.

Introduction

12. International monetary issues figured prominently at the first session of the United Nations Conference on Trade and Development. The Conference in its recommendation A.IV.19, was of the view that " it is necessary to ensure that any decisions reached on future organization of international monetary relationships should be made fully consistent with the purposes of the present Conference " and also that " any arrangements for the solution of the currency problems of the major trading countries should take fully into account the needs of developing nations ".[1] It therefore recommended the convening of a group of experts " to consider the international monetary issues relating to problems of trade and development with special reference to the objectives and decisions of this Conference, and devoting particular attention to the needs of the developing countries in their trade with one another and the rest of the world ".[2]

13. The Group of Experts on International Monetary Issues met in New York in October 1965 and its findings are contained in its report entitled *International Monetary Issues and the Developing Countries.*[3]

14. This report was considered by the Committee on Invisibles and Financing related to Trade both at the first session held in Geneva from 6 to 22 December 1965[4] and at the special session held in New York from 27 January to 4 February 1966.[5] At the conclusion of the discussion at the special session, the developing countries jointly presented a memorandum[6] to the Committee setting forth their position on international monetary issues. The Committee, while deciding to keep the report of the Group of Experts on its agenda, recommended that the Board transmit the report and other relevant documents to the international monetary institutions for their due consideration.[7] The Trade and Development Board at its third session approved this recommendation.[8]

15. At its twenty-first session, the General Assembly of the United Nations adopted unanimously resolution 2208 (XXI) on international monetary reform recognizing " the need for a reform of the international monetary system that would make it more responsive to the requirements of the economic growth of both developed and developing countries ". To that end, the General Assembly endorsed " the need for those developed and developing countries which so desire to be fully represented in the discussions and decisions leading to any new international monetary reform arrangements, including those relating to the problems of international liquidity, and to participate fully in the operation of such arrangements as may be made ". In addition, the General Assembly requested the Secretary-General of the United Nations Conference on Trade and Development (UNCTAD) to consult with the Managing Director of IMF on the progress of activity relating to international monetary reform and to report to the Trade and Development Board at its fifth session through the Committee on Invisibles and Financing related to Trade.

[1] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report* (United Nations publication, Sales No.: 64.II.B.11), p. 53.

[2] *Ibid.*

[3] United Nations publication, Sales No.: 66.II.D.2.

[4] See *Official Records of the Trade and Development Board, Third Session, Supplement No. 3* (TD/B/42/Rev.1), part II, chap. IV.

[5] *Ibid. Supplement No. 4* (TD/B/57 and Add. 1 and 2).

[6] *Ibid.*, annex I.

[7] *Ibid.*, para. 21.

[8] See *Official Records of the General Assembly, Twenty-first Session, Supplement No. 15* (A/6315/Rev.1), part one, para. 57.

16. The report of the Secretary-General of UNCTAD[9] was presented to the Committee on Invisibles and Financing related to Trade at its second session held in April 1967. During this session, several developing countries jointly presented a further memorandum setting forth their views on international monetary reform.[10] In accordance with the decision of the General Assembly, the progress report on international monetary reform was submitted to the Trade and Development Board at its fifth session, taking into account new developments that had occurred after the second session of the Committee on Invisibles and Financing related to Trade.[11] The present note reviews further developments up to and including the 1967 annual meeting of IMF at Rio de Janeiro.

The inadequate growth of world reserves

17. The growth of world reserves[12] has slowed down markedly since the end of 1964. Whereas they increased at an average annual rate of 3.3 per cent from 1960 to 1964, the rate of growth during the two following years averaged only 2.2 per cent per annum.[13]

18. Gold is still the most important component of the stock of world reserves, accounting for about 57 per cent of the total at the end of 1966. Since the end of 1964, the world stock of monetary gold, i.e., gold held by national monetary authorities and international monetary institutions, has hardly increased and in fact in 1966 it fell for the first time in the post-war period.[14] Given the levelling-off in the rate of growth of gold production,[15] and the growing intensity of non-monetary demand for gold, there seems little prospect that the flow of gold into official monetary holdings will rise sufficiently in the years ahead to meet reserve needs.

19. The foreign-exchange component of world reserves declined by $518 million in 1965 and the bulk of the increase in 1966 is accounted for by *ad hoc* factors. Thus of the total increase of $1,370 million in 1966, $900 million was due to a transfer of dollar holdings to the United Kingdom's reserves, representing the proceeds of liquefying part of the United Kingdom Treasury's dollar security portfolio. Of the remaining increase of $470 million, a large part was due to the acquisition of foreign exchange by national monetary authorities as a result of swap and other credit operations between them. Since foreign exchange acquired under such operations is in the nature of credit and hence is repayable, reserves would tend to decrease when repayments fall due.

20. Until recently the most important source of additions to world reserves of foreign exchange has been the balance-of-payments deficits of reserve currency countries. Such deficits cannot, however, continue indefinitely without undermining confidence in the key currencies and this in turn tends to be reflected in a growing unwillingness of central banks to add further to their holdings of the key currencies. If, as has recently been observed, recipient countries acquiring reserve currencies seek to convert them into gold, the link between the deficits of the reserve currency countries and the growth of world reserves is destroyed. It is therefore generally recognized that " Large United States deficits are not a satisfactory source of future reserve increases for the rest of the world nor are they acceptable to the United States ".[16]

21. Reserve positions in IMF accounted for nearly 70 per cent of the total increase in world reserves from 1964 to 1966. However, this increase was also the product of special factors. For example, in 1965, the United Kingdom's drawing of the equivalent of $1.4 billion, which increased its outstanding drawings in the credit tranches and reduced its conditional drawing rights to the same extent, added $1 billion to other countries' gold tranche positions and loan claims on IMF.[17] In 1966, the most important factor in the increase in reserve positions in IMF was the net payment of gold to IMF on account of quota increases. Since reserve positions in IMF created by other countries' use of credit tranches are reversed when the credits are repaid, they cannot form the basis of any significant regular or permanent addition to world reserves. Similarly, reserve positions created by gold subscriptions to IMF merely replace gold holdings of national monetary authorities. IMF has therefore concluded that the role played by reserve positions in IMF in adding to world reserves " is likely to be limited or even negative in the immediate future. "[18]

22. The foregoing account makes it clear that not only has the growth of world reserves slowed down considerably since the end of 1964 but also that whatever increase has actually taken place has been due largely to *ad hoc* factors, associated with the grant of (repayable) credits to countries in balance-of-payments difficulties. Indeed, the creation of new reserves was only an incidental result of these operations. Moreover, as pointed out by the Bank for International Settlements

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[9] *Official Records of the Trade and Development Board, Fifth Session, Annexes,* agenda item 7, document TD/B/115.

[10] *Ibid., Fifth Session, Supplement No. 3* (TD/B/118/Rev.1), annex III.

[11] *Ibid., Fifth Session, Annexes,* agenda item 7, documents TD/B/115/Add.1-2.

[12] For want of information, " world " reserves exclude throughout the reserves of socialist countries of Eastern Europe and Asia.

[13] In absolute terms, reserves increased by $1.7 billion in 1965 and $1.4 billion in 1966.

[14] The total stock of world monetary gold amounted to $43.015 billion in 1964, $43.225 billion in 1965 and $43.115 billion in 1966. See IMF, *International Financial Statistics,* vol. XX, No. 9, September 1967.

[15] World gold production (excluding socialist countries) in 1965 has been estimated by IMF to be of the order $1.440 billion; the corresponding estimate for 1966 is $1.442 billion. *(Ibid.)*

[16] See Group of Ten, *Communiqué of Ministers and Governors and Report of Deputies* (July 1966), " Communiqué of the Ministerial Meeting of the Group of Ten on July 25th and 26th in The Hague," para.4.

[17] IMF, *Annual Report of the Executive Directors for the Fiscal Year ended April 30th, 1967* (Washington, D.C., 1967), p. 16.

[18] *Ibid.*, p. 17.

(BIS): "With the importance of special transactions, global reserves are a less homogeneous and meaningful aggregate than they used to be; as the assets that arise from official credit arrangements are to some extent not readily marketable, they do not provide the same degree of 'liquidity' as traditional reserves. This may not be important so long as the volume of such assets is relatively small, but a problem could arise if they were relied upon for the continuous growth of global reserves".[19]

The adoption of an agreed outline of a contingency plan

23. In view of the circumstances described above, there is now general agreement that the existing international monetary system cannot be relied upon to bring about an orderly growth of reserves in harmony with the requirements of an expanding world economy. The recognition of this fact has provided the basis for studies which have led to the adoption of an agreed outline of a contingency plan for the deliberate creation of reserves.

24. The future of the international monetary system has been under active discussion both in IMF and in the Group of Ten, comprising the industrialized countries which are IMF's partners in its General Arrangements to Borrow.[20] At an early stage IMF had kept in touch with the Group of Ten through the participation of its Managing Director in meetings of the Ministers and Governors of the Ten and IMF staff members at meetings of the Deputies. At a later stage, direct contact was established between the Group of Ten on the one hand and the Executive Directors of IMF on the other through four series of joint informal meetings held between November 1966 and June 1967. At the last meeting held in Paris from 19 to 21 June 1967, agreement was reached on the outline of a scheme aiming at the creation of special drawing rights within the framework of IMF.

25. However, there still remained some unsettled questions relating principally to the conditions for reconstitution of special drawing rights and decision-making in the new system. The remaining differences were resolved in the course of two Ministerial meetings of the Group of Ten held in July and August 1967. On 11 September 1967, IMF released the text of an "Outline of a Facility Based on Special Drawing Rights in the Fund" as approved by the Executive Directors for submission to the Board of Governors of IMF. At its Twenty-Second Annual Meeting, held in Rio de Janeiro from 25 to 29 September 1967, the Board of Governors of IMF requested the Executive Directors to submit by 31 March 1968, a report proposing amendments to the Articles of Agreement and the By-Laws of IMF for the purpose of establishing a new facility on the basis of the Outline.[21] After approval by the Board of Governors, the text of that amendment would be submitted to Governments for ratification.

26. The resolution adopted at the Rio meeting also provides that the Executive Directors should proceed with their work relating to "improvements in the present rules and practices of the Fund based on developments in world economic conditions and the experience of the Fund since the adoption of the Articles of Agreement of the Fund". The Executive Directors are required to submit by 31 March 1968 a report "proposing such amendments to the Articles of Agreement and the By-Laws as would be required to give effect to those modifications in the present rules and practices of the Fund" which they will recommend. These studies have been undertaken largely at the initiative of the countries of the European Economic Community (EEC), which have taken the view that the present strength of the Six and their union in EEC must, in any event, ensure that they have a proper influence in IMF, particularly in the voting procedure.[22]

27. A question has arisen as to the extent to which the amendment of IMF's Articles of Agreement and By-Laws to permit the introduction of special drawing rights is linked with the amendment relating to the present rules and practices of IMF. On one view, the two proposals are independent and the adoption of the one is not conditional on the adoption of the other. The opposite view is that the two amendments are indissociably linked.

The nature and form of the new reserve asset

28. The new facility is to be established within the framework of IMF by creating special drawing rights operated through a Special Drawing Account. The operations of, and resources available under, the Special Drawing Account will be kept separate from the operations of IMF as at present constituted, which will be referred to as the General Account.

29. A country using its special drawing rights will be entitled to acquire an equivalent amount of convertible currencies either directly from another participant or through the Special Drawing Account.

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[19] BIS, *Thirty-seventh Annual Report, 1st April 1966—31st March, 1967* (Basle, 1967), p. 36.

[20] The General Arrangements to Borrow constitute an agreement between IMF and the Group of Ten under which the members of the Group of Ten have agreed to lend their currencies to IMF up to specified amounts. The currencies so loaned can be utilized by IMF only when the lending country and IMF are agreed that such additional resources are necessary. These arrangements were first negotiated for a period of four years beginning in October 1962. They were extended for a further period of four years from October 1966. The members of the Group are: Belgium, Canada, Federal Republic of Germany, France, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States.

[21] Resolution 22-8, adopted on 29 September 1967, by the Board of Governors of the Fund, in Joint Session with the Boards of Governors of the International Bank for Reconstruction and Development, the International Finance Corporation and the International Development Association (see IMF, *Summary Proceedings, Annual Meeting, 1967* (Washington, D.C., 1967), pp. 271-272. For text of the "Outline," see attachment to resolution 22-8 *(ibid.,* pp. 272-279).

[22] Communiqué of the Finance Ministers of the members of EEC of 18 April 1967.

30. At an earlier stage of negotiations, two alternative schemes were under active consideration and the new agreed scheme combines some features of both the earlier schemes. One of the schemes involved the creation of automatic drawing rights of the gold tranche type, with additional currencies necessary for the operation of the scheme being made available to IMF through lines of credit. The second scheme involved the creation of a new reserve unit, the transferability of which was ensured by the participants' obligation to accept it within certain quantitative limits.

31. Merits were claimed for both types of scheme. Thus, in favour of the automatic drawing rights scheme it was argued that it would employ techniques already well known in IMF and this aspect commended it to those who stressed the desirability of building on familiar foundations. On the other hand, the advocates of a reserve unit scheme thought that reserve units would be "more in line with the reserve assets traditionally held by monetary authorities and would be more readily seen by them, by the markets and by the public at large as a supplement to gold".[23] On the latter view, credit facilities, even when of an unconditional nature, are not a complete substitute for "owned" reserves "for repayment terms are usually at the discretion of the lender, and this can often cause considerable inconvenience, if not hardship, for the borrower".[24] While it was recognized that the obligation and the necessity to replenish after use are not less urgent in the case of "owned" reserves than for credit facilities, it was pointed out that in the former case replenishment can take place at the convenience of the user.[25] The system of special drawing rights represents a compromise solution, attempting to reconcile the two different schools of thought referred to above.

32. To an even greater extent than the existing gold tranche facilities in IMF, special drawing rights represent unconditional liquidity. A participant will be able to use them without its judgement of need being subject to prior challenge.[26]

33. Similarly, like the existing practice in IMF, a member's choice of currencies drawn upon will normally be subject to guidance from IMF based on the following general principles:

"*(a)* Normally, currencies will be acquired from participants that have a sufficiently strong balance of payments and reserve position, but this will not preclude the possibility that currency will be acquired from participants with strong reserve positions even though they have moderate balance of payments deficits."

"*(b)* The Fund's primary criterion will be to seek to approach over time, equality among the participants indicated from time to time by the criteria in *(a)* above, in the ratios of their holdings of special drawing rights, or such holdings in excess of net cumulative allocations thereof, to total reserves."[27]

34. Drawing rights used within the traditional framework of IMF have to be reconstituted over a period of three to five years. Special drawing rights created under the new scheme will also carry reconstitution obligations. The reconstitution obligations during the first basic period of the scheme's operation are such that reconstitution will be necessary only if, and to the extent that, the average net use, taking into account both use below and holdings above its net cumulative allocation, made by a participant of its special drawing rights calculated on the basis of the preceding five years, exceeds 70 per cent of its average net cumulative allocation during this period.[28] Members are also expected to pay due regard to the desirability of pursuing over time a balanced relationship between their holdings of special drawing rights and other reserves.

35. While the new scheme has many features of the existing gold tranche facilities in IMF, automatic drawing rights under the present system come into existence either as a result of gold subscriptions to IMF or as an incidental outcome of drawing in the credit tranches made by countries facing payments difficulties. As these drawings are repaid, reserve positions in IMF contract accordingly. Under the new scheme, instead, special drawing rights will be created deliberately in amounts considered necessary in the light of reserve requirements, and constitute a permanent addition to the total of reserves, assuming that the scheme is renewed.[29]

Distribution of the new reserve asset

36. Under the new scheme, participation in the Special Drawing Account will be open to all members of IMF that accept the obligations of the scheme. The distribution of special drawing rights to members will be expressed as a percentage of quotas, uniform for all members. A member's quota in IMF will be the same for the purposes of both the General and the Special Drawing Accounts of IMF.

37. These arrangements represent a considerable advance over the thinking which had prevailed previously

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[23] Group of Ten, *op. cit.*, "Report to Ministers and Governors by the Group of Deputies," para. 54.

[24] See Inter-American Committee on the Alliance for Progress (CIAP), *International Monetary Reform and Latin America: Report to CIAP by the Group of Experts* (Washington, D.C., Pan-American Union, 1966), p. 20.

[25] *Ibid.*

[26] However, if in IMF's judgement a member has not used its special drawing rights because of balance of payments requirements or in the light of developments in its total reserves, but has used them for the sole purpose of changing the composition of its reserves, IMF may make representation to such a member and may direct drawings to it.

[27] See IMF, *Summary Proceedings, Annual Meeting, 1967, op. cit.*, pp. 276-277. In addition, a reserve centre that wishes to purchase balances of its currency held by another participant is free to direct its drawing specifically to such a participant, provided the latter agrees. Moreover, the Fund's rules and instructions for guidance will cover use of special drawing rights in accordance with reconstitution provisions.

[28] Reconstitution rules are to be reviewed before the end of the first and of each subsequent period and new rules will be adopted, if necessary.

[29] Special drawing rights created under the scheme can also, however, be cancelled.

in relation to the criteria for the distribution of new reserves. At one stage of the negotiations, for example, it had been suggested that the distribution of new reserve units should be limited to a small group of industrialized countries, while the needs of developing countries could best be met through conditional credit facilities.

38. The report of the UNCTAD Group of Experts on International Monetary Issues, deliberations in UNCTAD and in the General Assembly of the United Nations, as also the firm position on this matter taken by the Managing Director of IMF, helped to remove objections to the full and equal participation of developing countries.

39. While the principle of universal participation is observed as far as IMF members are concerned, the recommendations of the UNCTAD Group of Experts for a " truly international " reform had gone somewhat beyond this :

> " We are aware that membership of the IMF is not universal, but we hope that the reforms being discussed may be accomplished with the participation (perhaps in an associate capacity) of countries not now members, if they are prepared to take part in both the benefits and the obligations of new monetary arrangements designed to serve the interests of the international community as a whole. "[30]

No provision has been made for participation in the scheme by non-members of IMF.

Conditions of acceptability

40. The acceptability of the new asset to any individual participant would be primarily the result of acceptance obligations assumed by other participating countries. However, in order to enhance the acceptability of the new asset and also to induce members to hold it, special drawing rights will carry a gold value guarantee and also a moderate rate of interest. The cost of this interest payment is to be assessed against all participants in proportion to net cumulative allocations of special drawing rights to them.

41. However, a participating country's obligation to accept special drawing rights is not unlimited. In order to make it possible for individual participants to avoid acquiring a disproportionate share of these drawing rights, a participant's obligation to provide currency is not to go beyond the point at which its holdings of special drawing rights in excess of the net cumulative amount of such rights allocated to it are equal to twice that amount. A participant may, however, accept larger amounts of special drawing rights.

The concept of a basic period

42. The decision to create drawing rights will be taken for a basic period, normally of five years' duration. The rate or rates at which special drawing rights will be allocated during the basic period will also be specified in that decision.

The activation of the contingency plan

43. In discussions leading up to the adoption of the agreed outline, it has been customary to draw a distinction between the establishment of a contingency plan to deal with a potential shortage of reserves, and the activation of that plan. The Communiqué of the Ministerial Meeting of the Group of Ten of July 1966 emphasized this distinction and also suggested that prerequisites of activation " should include the attainment of a better balance of payments equilibrium between members and the likelihood of a better working of the adjustement process in the future ".[31] The question of the conditions for the activation of a contingency plan was also discussed at the second joint meeting of Executive Directors of IMF and the Deputies of the Group of Ten held in London during January 1967. There was a general consensus that, although conditions such as those listed in the Communiqué had to be kept in view in the activation of a contingency plan, there could not be a rigid or mechanical link between the balance-of-payments situations of particular countries and the activation of a contingency plan.[32]

44. The " agreed Outline of a Facility based on Special Drawing Rights in the Fund " is silent on the conditions of activation, for it states only that " special considerations applicable to the first decision to allocate special drawing rights... will be included in the introductory section of the Amendment and, to the extent necessary, in a Report explaining the Amendment ". The conditions of activation have therefore still to be determined and a collective judgement will be required as to whether sufficient progress has been made towards a more satisfactory operation of the existing adjustment processes and the attainment of a better balance-of-payments equilibrium in the key currency countries.

45. It is also not clear how far countries are agreed on the existence of a present need for increasing world liquid reserves. It was pointed out in paragraph 22 above that the growth of world reserves has slowed down markedly since the end of 1964 and that whatever growth has actually taken place since then has been due largely to *ad hoc* and often reversible factors. It would thus appear that in the absence of a deliberate creation of additional reserves, the period ahead may be one of competition among countries for a stagnant or even dwindling level of reserves, leading to further strains in world payments.

46. Some of the symptoms of inadequacy of reserves have been listed in the *Report of the Study Group on the Creation of Reserve Assets* by the Group of Ten dated 31 May 1965. In the words of this report :

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[30] See Group of Experts on International Monetary Issues, *op. cit.*, para. 68(d).

[31] *Op. cit*, para. 6A.

[32] Statement to the press by Dr. Otmar Emminger, Chairman of the Deputies of the Group of Ten and Co-Chairman of the joint meetings of the Executive Directors of IMF and the Deputies of the Group of Ten, on 26 January 1967.

"... An indication that reserves are inadequate might be found in a reluctance to extend intergovernmental credit, or in an increasing propensity to seek credit, in preference to parting with reserve assets. Clearer evidence of a general scarcity might be found in a marked tendency to make maintenance, increase or restoration of reserves an overriding objective of economic policy, taking priority over other fundamental objectives, such as economic growth, a high level of employment and freedom of international trade. Indeed, a general scarcity might well have been permitted to develop too far when such tendencies became evident. In that situation, the anxiety to retain or increase reserves would probably lead countries to adopt excessively restrictive policies to prevent the emergence of a payments deficit or to achieve a surplus. In such conditions, therefore, the absence of large imbalances would not necessarily be evidence that reserves were adequate."

47. There are indications that many of these symptoms have been present in the world economy in recent years. The fact that aid to the developing countries has failed to increase materially during the past few years despite rapid economic growth in the industrialized countries, that aid is tied not only by deficit but by surplus countries as well, and that progress in the reduction of tariff and non-tariff barriers to the flow of exports of developing countries is very slow, suggest that countries' policies are being increasingly influenced by their preoccupation with the state of their reserves.[33] Thus developing countries have a strong interest in measures to alleviate the world shortage of reserves, which has contributed to restrictive trade and aid policies in surplus as well as in deficit countries.

The decision-making process

48. The agreed Outline lays down that decisions to create special drawing rights (including the basic period for, timing of, or rate of allocation of these drawing rights) would have to be taken by an 85 per cent majority of the total voting power of all participants.[34] This is more strict than the existing practice in IMF whereby decisions to increase IMF quotas have to be taken by an 80 per cent majority of the total voting power, while most of the remaining decisions require only a simple majority of votes cast.

49. The outline also envisages a complex process of consultations to precede actual voting. These consultations are to be organized by the Managing Director of IMF, who is charged with the responsibility for making a proposal which, after concurrence by the Executive Directors, would be put before the Board of Governors for vote. The purpose of consultations to be organized by the Managing Director is to ensure that there is broad support among the participants for the various elements which are to be included in his proposal.

50. The larger majority required for decisions on the new scheme strengthens the bargaining power of any group of countries which can muster more than 15 per cent of the total vote. It is, of course, unlikely that the new arrangements would prove workable if they did not command the willing support of major participants, and in this sense the higher majority merely recognizes a basic feature of the current political landscape. On the other hand, small countries would be vitally affected if a stalemate between major voting groups developed in a situation calling for urgent action.

The link with development finance

51. Now that agreement has been reached on a scheme for the creation of a new form of international monetary reserve, renewed consideration may be given to the implications of this decision for the flow of aid to the developing countries. Balance-of-payments difficulties have been cited by some of the main aid-giving countries as a major obstacle to the expansion of aid. Even surplus countries have been reluctant to add to their aid commitments, some in the belief that their surpluses were a temporary phenomenon, some from a desire to add to their foreign exchange reserves or to protect the attained level of reserves. In so far as the creation of new reserves eases the process of international balance-of-payments adjustment, it creates a presumption that the flow of aid could be increased likewise.

52. Both the UNCTAD and CIAP Groups of Experts on international monetary issues came to the conclusion that it was feasible and desirable to establish a link between the creation of international liquidity and the provision of development finance, without detriment to either process. They suggested that while monetary considerations alone should determine the amount of any reserves to be created, such a link would be in harmony with the basic objectives of international monetary reform—namely, the promotion of expanding levels of income, trade and aid.

53. Opposition to the link has arisen principally from the view that reserve creation should not become a mechanism for effecting permanent transfers of real resources from one set of countries to another and that it should therefore be kept materially separate from development assistance.[35]

54. The UNCTAD Group of Experts agreed that a link between liquidity creation and development finance cannot be established without a transfer of real resources. However, they pointed out that there was nothing in the least forced or unusual in the linking together of liquidity creation and transfer of resources. To quote their report:

[33] One of the major findings of the UNCTAD Group of Experts on International Monetary Issues was that "there appears to be a *prima facie* case that the general level of reserves is inadequate, or in imminent prospect of becoming so" (*op. cit.*, para. III). The CIAP Group of Experts which reported in 1966 also concluded that developments that would indicate an incipient shortage of liquidity exist now and that "a shortage of reserves is a very real danger" (*op. cit.*, p. 10).

[34] However, decisions to decrease the rate of allocation of special rights for the remainder of a basic period may be taken by a simple majority of the total voting power.

[35] "We are agreed that deliberate reserve creation is not intended to effect permanent transfers of real resources from some countries to others." (Group of Ten, *op. cit.*, "Report to Ministers and Governors by the Group of Deputies," para. 40.)

"Every domestic banking system, for example, creates liquidity for individuals in the form of deposits and simultaneously effects a more or less permanent transfer of real resources from those who are normally creditors of the system to those who are normally borrowers. In the international sphere a similar combination is found in the present activities of the International Monetary Fund where real resources are transferred from those countries that hold reserve positions on the Fund to those that have drawings outstanding. The same point would apply even under a gold standard system in that the countries whose monetary authorities acquire gold for their reserves transfer real resources in the form of exports of goods and services to countries where the gold is mined."[36]

55. It would appear that most developed countries would like, if possible, to maintain a surplus in their balance of payments on current accounts. The only way in which all developed countries could simultaneously succeed in attaining this objective would lie through the maintenance of an over-all surplus by the developed countries as a group with the developing countries; otherwise the surpluses of some developed countries inevitably have their counterpart in the deficits of others. As matters now stand, however, the disadvantage of an over-all surplus with developing countries is that the asset acquired in exchange is only the indebtedness of these countries. At a time of universal preoccupation with actual and potential reserve positions, developed countries might be more willing to maintain an export balance with developing countries if that balance could be made to yield an asset in the form of internationally accepted reserves.

56. Two main forms of the link could be envisaged. On the one hand, it would be possible to provide that the process of reserve creation itself should be carried out in such a manner as to add to the flow of development finance. Alternatively, it would be possible to take parallel and simultaneous action in the two fields of liquidity creation and provision of aid.

57. The first of these two approaches could take the form of the allotment of a part of any newly created special drawing rights to the International Bank for Reconstruction and Development (IBRD) or to IDA under agreed rules.

58. While there are important advantages in an "organic" link of this type, the requirements of the situation could equally well be met if a convention were adopted whereby acts of international liquidity creation were accompanied by voluntary contributions to IDA by all the Part I member countries of IDA —the size of the voluntary contribution being a certain uniform proportion of the share of each Part I country in international liquidity creation. By these means, it would be possible to secure generous replenishment for IDA from time to time without any fear that some countries might stand to lose reserves as a result of their contributions to IDA—a fear that has played a major part in the current delay in IDA replenishment.

59. Whatever objections there may be to the link in its "organic" form, the same objections do not apply to the alternative version of the link outlined above. What is involved here is the acceptance of parallel and simultaneous commitments to increase aid by developed countries benefiting from allocations of special drawing rights. Since one of the objectives of the new reserves is presumably to encourage more liberal trade and aid policies, the assumption of such parallel obligations would be in the spirit of the reform, while maintaining the separate and independent character of the two processes—liquidity creation and the provision of development finance.

Changes in the existing rules and practices of IMF

60. As pointed out earlier, the Board of Governors of IMF has instructed the Executive Directors to review the rules and practices relating to the traditional activities of IMF and to submit by 31 March 1968 a report proposing amendments in the Articles of Agreement and By-Laws of IMF in order to give effect to modifications which they will recommend. The Monetary Committee of EEC is understood to have made certain proposals in this regard which have not been made public so far. However, from certain statements at the Rio meeting of the Board of Governors it appears that one of these proposals would involve raising to 85 per cent the voting majority required for the principal decisions in IMF, especially those relating to a general change in quotas or regarding the creation of additional facilities.[37] Concern has been expressed as to whether the requirement for a higher majority might render IMF policies governing drawings in the credit tranches more restrictive than they now are.[38] Moreover, there is a proposal to revise the existing definition of reserves used by IMF,[39] the purpose of which may be to lay down stricter rules governing repurchases of IMF drawings. Another proposal seeks to enhance the status of drawings in the gold tranche, and calls for full automaticity of such drawings.[40]

61. At the Rio meeting of the Board of Governors of IMF, Governors representing developing countries also put forward suggestions for improvements in the existing rules and practices of IMF. Thus, many Governors stressed the desirability of greater automaticity in the use of IMF resources.[41] It was suggested

[36] Group of Experts on International Monetary Issues, *op. cit.*, para. 97.

[37] Statement by Mr. J. Zijlstra, Governor of IMF for the Netherlands, on 28 September 1967 (IMF, *Summary Proceedings, Annual Meeting, 1967, op. cit.*, p. 145).

[38] Statement by Mr. William McMahon, Governor of IMF and IBRD for Australia, on 26 September 1967 (*ibid.*, p. 32).

[39] Statement by Mr. Michel Debré, Governor of IBRD for France, on 26 September 1967 (*ibid.*, p. 66).

[40] Statement by Mr. Hubert Ansiaux, Governor of IMF and Alternate Governor of IBRD for Belgium, on 28 September 1967 (*ibid.*, p. 132).

[41] Statements by Mr. Francis C. Prevatt, Governor of IMF and IBRD for Trinidad and Tobago, and by Mr. U. B. Wanninayake, Governor of IMF and IBRD for Ceylon, on 26 September 1967 (*ibid.*, p. 88 and p. 92).

that the terms of repurchase applicable to developing countries needed to be further liberalized, linking them to the recovery of exports.[42] It was further argued that the limit for repurchase ought to be extended to seven years in the case of developing countries.[43] IMF was requested to provide special facilities for dealing with payments problems arising in connexion with regional integration.[44] It was also proposed that provision should be made for selective increases in the present quotas of developing countries taking into account the special problems facing these countries.[45]

62. IMF has been in operation for over two decades. It is therefore understandable that some need is felt for revision of some of its existing rules and practices in the light of past experience and the present structure of international economic relationships. However, the objectives of any revision of these rules and practices should be to strengthen the character of IMF as a multilateral agency responsible for promoting world-wide monetary co-operation. Any effort to counter-balance the creation of special drawing rights by the application of more restrictive conditions on the existing operations of IMF might have serious effects on developing countries and would run counter to the widespread desire of these countries for greater automaticity in ordinary drawings. The benefits to be derived by the developing countries from special drawing rights would, in the absence of the link, be limited by the size of their IMF quotas. If, therefore, agreement on new reserve creation were accompanied by the introduction of more restrictive provisions with respect to the ordinary operations of IMF, including the process of increasing quotas, the developing countries might on balance find themselves no better off than before. Any revision of the present rules and practices of IMF should therefore take the wider interests of the entire world community into account.

[42] Statement by Mr. Clovis Desinor, Governor of IBRD for Haiti, on 29 September 1967 (*ibid.*, p. 224).

[43] Statement by Mr. U. B. Wanninayake.

[44] Statement by Mr. Antonio Delfim Netto, Governor of IMF and IBRD for Brazil, on 28 September 1967 (*ibid.*, p. 164).

[45] Statement by Mr. U. B. Wanninayake.

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Progress report on compensatory financing of export fluctuations
Note by the UNCTAD secretariat

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Introduction

1. The United Nations Commission on International Commodity Trade, at its tenth session held in Rome in May 1962 invited the International Monetary Fund (IMF) to present "as soon as possible, a report as to whether and in what way the IMF might play an increased part in the compensatory financing of export fluctuations of primary exporting countries...".[1] In response to the invitation extended by the Commission, the Fund published in February 1963 a report containing a decision by the Executive Directors to establish, within the Fund, a new facility for compensatory financing of export fluctuations, designed particularly to benefit countries exporting primary products.[2] The United Nations Conference on Trade and Development at its first session, while welcoming the Fund decision of February 1963 as "a definite step towards the solution of short-term financing problems" adopted recommendation A.IV.17 for study by Governments members of IMF with a view to a further extension and liberalization of the Fund facility.[3] Similar recommendations were also made by an UNCTAD Group of Experts convened in October 1965.[4] In the light of these recommendations and other relevant considerations, the Fund reviewed its compensatory financing facility in September 1966 and announced its decision[5] to modify certain features of the 1963 decision on compensatory financing.[6] This note outlines the major features of the 1963 Fund decision as also of the amended Fund facility and also indicates the extent to which the amended facility has incorporated the relevant recommendations of the Conference at its first session and of the UNCTAD Group of Experts.

[1] See United Nations Commission on International Commodity Trade, report on the tenth session (*Official Records of the Economic and Social Council, Thirty-fourth Session, Supplement No. 6*), para. 55.

[2] IMF, *Compensatory Financing of Export Fluctuations: A Report by the International Monetary Fund* (Washington, D.C., 1963).

[3] See *Proceedings of the United Nations Conference on Trade and Development*, vol. I, *Final Act and Report*, p. 52.

[4] United Nations, *International Monetary Issues and the Developing Countries—report of the Group of Experts* (United Nations publication, Sales No. 66.II.D.2).

[5] See IMF, *Compensatory Financing of Export Fluctuations: A Second Report by the International Monetary Fund* (Washington, D.C., 1966), chap. V.

[6] *Ibid.*, appendix III.

The 1963 Fund decision on compensatory financing

2. The major features of the Fund facility for compensatory financing of export fluctuations as it operated since its inception on 27 February 1963 until 20 September 1966 are set out below.

3. The facility was designed to compensate for shortfalls in export receipts identified to be of a short-term character and attributable to circumstances beyond the control of the member concerned.

4. Temporary export shortfalls were defined as shortfalls of actual exports from a medium-term trend in export earnings. The trend value or the norm was to be established by the Fund, in conjunction with the member concerned, "on the basis of appropriate statistical data in conjunction with qualitative information about its export prospects".[7]

5. The 1963 decision of the Executive Directors did not contain a definition of the medium-term trend. However, in all applications of the scheme to particular countries the trend of the norm was defined "as the average of actual exports for the five years beginning two years before and ending two years after the year for which the trend value was calculated".[8] The actual estimate of the trend value was derived by using two separate techniques: one involving the application of a statistical formula to exports of the year of the shortfall and the two preceding years, and the second requiring judgement as to the export prospects for the two years following the year of the shortfall.[9]

6. Under the first approach, the norm for any year was estimated as the weighted average of actual exports for the year in question and those of the two preceding years. This approach avoided the necessity of forecasting the value of exports during the two years following the year of the shortfall. In this connexion, the Fund used two types of statistical fomulae, a "general" formula and a "national" formula. The "general" formula attached uniformly a weight of 0.50 to the exports of the year for with the shortfall was to be calculated, 0.25 to the preceding year and 0.25 to the second preceding year. "National" formulae varied from

[7] *Ibid.*, II, B. (7).

[8] See *Compensatory Financing of Export Fluctuations: A Second Report by the International Monetary Fund*, p. 5.

[9] *Ibid.*, p. 6.

country to country, the formula for each country being arrived at on the basis of the export experience of that country alone.

7. The second approach varied from country to country, but the procedure involved estimating, by market analysis, the average exports anticipated for the two years following the year for which the shortfall was being calculated, and then taking an average of the five years centred on the shortfall year.

8. The results obtained by the two approaches described above were given approximately equal weight in determining the final estimate of the trend value of exports.[10]

9. Compensation was given in the form of a drawing which was subject to the Fund's established policies and practices on repurchase, including an outside limit of three to five years.

10. Compensatory drawings were subject to the proviso that the total of such drawings outstanding would not normally exceed 25 per cent of the member's quota.

11. In order to implement its decision on compensatory financing, the Fund expressed its readiness to raise the ceiling on its holdings of a member's currency from 200 per cent to 225 per cent of a member's quota, wherever appropriate.

12. Drawings under the compensatory financing facility were conditional in the sense that a member had to satisfy the Fund that it was facing payments difficulties, that the shortfall was of a short-term character and was largely attributable to circumstances beyond its control, and that the member would co-operate with IMF in an effort to find, where required, appropriate solutions for its payments difficulties.[11] The intention was that policies of members drawing under the facility would be subject to less rigorous tests than those applicable in the case of a non-compensatory drawing in the same tranche. On the other hand, compensatory drawings were regarded as equivalent to ordinary drawings from the standpoint of their effect on the conditions to be applied to subsequent ordinary drawings. In other words, a compensatory drawing could have the effect of shifting a country's position from the first to the second credit tranche, or from the second to the third, thereby affecting the rigour of the conditions requiring to be satisfied in the event that a further ordinary drawing was needed.

[10] *Ibid.*, p. 8.

[11] " In the application of the Decision to individual cases, the Fund, in accordance with the intention of the Decision, has not attempted to reach agreement with the member on what the nature of these solutions would have to be. This has been left to subsequent discussions, and has not stood in the way of prompt action on requests for compensatory drawings. Nevertheless, in one instance in which a compensatory drawing was requested, the country concerned made, at the time of the request, a statement of the policies it intended to follow. In the two other compensatory drawings, the Fund subsequently reached agreements on appropriate policies with the countries in question " (*Ibid.*, p. 16).

Recommendation A.IV.17 of the United Nations Conference on Trade and Development

13. In recommendation A.IV.17 the United Nations Conference on Trade and Development recommended the following measures for study by Governments members of IMF :

" (1) To increase, as soon as possible, the amount allocated by the Fund to compensatory financing, over and above its current transactions, from 25 per cent to 50 per cent of a member country's quota.

" (2) To place compensatory credits entirely outside the structure of the gold and successive credit tranches, so that the drawing of compensatory credits would not directly or indirectly prejudice a member's ability to make an ordinary drawing.

" (3) To explore ways to secure possible refinancing of compensatory financing obligations of the developing countries in the event of a persistent shortfall in export receipts beyond the control of the country affected ".

The Conference also requested that " the International Monetary Fund, in its determination of the shortfall in export receipts, consider giving greater weight to the actual experience of the three preceding years ".

Recommendations of the UNCTAD Group of Experts

14. The UNCTAD Group of Experts on International Monetary Issues reporting in October 1965 found that the Fund facility had " several shortcomings which could be remedied ".[12] The group favoured the enlargement of the scope of the facility along the lines of recommendation A.IV.17 of the Conference. To that end, it made the following recommendations :

(a) The amount allocated by the Fund to compensatory financing, over and above its current transactions, should be increased from 25 per cent to 50 per cent of a member country's quotas and that " in the course of time this revised limit could with advantage be extended ".

(b) Compensatory credits should be entirely outside the structure of gold and credit tranches so that drawings on such credits would not directly or indirectly prejudice a member's ability to make an ordinary drawing.

(c) The criteria for determining shortfalls should be given further study taking into account the effects of changes in the terms of trade and the proposal that greater weight be given to the experience of the three preceding years might also be considered.

(d) Repayment obligations in respect of compensatory drawings might be linked more directly to the recovery of exports and there was a " need for refinancing the facility in case exports do not recover ".[13]

[12] United Nations, *International Monetary Issues and the Developing Countries, Report of the Group of Experts, 1965, op. cit.*, para. 56.

[13] *Ibid.*, paras. 56-58.

The revised Fund facility

15. On 20 September 1966, the Executive Directors of the Fund amended their 1963 decision on compensatory financing of export fluctuations along the following lines (see para. 1 above).

16. The facility was extended to permit outstanding compensatory drawings up to an amount equivalent to 50 per cent of a member's quota, but with the qualification that "except in the case of shortfalls resulting from disasters or major emergencies, such drawings will not be increased by a net amount of more than 25 per cent of the member's quota in any 12-month period ". Moreover, whereas in the case of compensatory drawings within the first 25 per cent of the quota, the Fund has to be satisfied that " the member will co-operate with the Fund in an effort to find, where required, appropriate solutions for its balance-of-payments difficulties ", compensatory drawings in excess of 25 per cent of quota are to be granted only if the Fund is also satisfied " that the member has been co-operating with the Fund in an effort to find, where required, appropriate solutions for its balance-of-payments difficulties ".

17. Short-term export shortfalls will continue to be identified as deviation from the medium-term trend value of exports based as before " partly on statistical calculation and partly on appraisal of export prospects ". Previously, the Fund used both a " general " as well as " national " statistical formula. However, the use of " national " formulae is to be discontinued on the ground that they are based on too small a number of observations, and complicate the statistical side of the shortfall determination. It was considered that a somewhat greater weight than in the past should be assigned to calculations of the five-year average, centred on the shortfall year, and based in part on an appraisal of export prospects during the two succeeding years, as against calculations involving the application of statistical formulae to the exports of the shortfall year and of the two preceding years. In order to give members some assurance that estimates of the trend value of exports remain within a certain predictable range the average level of exports for the two years following the shortfall year will not be assumed to exceed by more than ten per cent the average level experienced in the two years preceding the shortfall year and will not be assumed to be less than the level of exports experienced in the shortfall year itself.

18. The compensatory financing facility has been placed outside the structure of the ordinary facilities of the Fund, in the sense that the amount of outstanding drawings under the compensatory facility will not affect members' ability to draw from the Fund under its policies regarding ordinary drawings in the various credit tranches. Thus the Fund will apply its tranche policies to ordinary drawings by a member as if its holdings of the member's currency were less than its actual holdings of that currency by the amount of any drawings outstanding under the compensatory facility. In order to implement its revised decision, the Fund has expressed its readiness to raise the limit on Fund holdings of a member's currency to 250 per cent of a member's quota, wherever appropriate.

19. A member may, within six months of an ordinary drawing, request the reclassification of all or part of it as a compensatory drawing, and thus restore to that extent its normal drawing rights for future contingencies, provided that, in the circumstances existing at the time of the request for reclassification, the member could make a compensatory drawing for that amount.

20. As regards the repayment system appropriate to compensatory drawings, the existing practice, whereby members repay the Fund within the limit of three to five years, has been retained. At the same time, in order to encourage members to reduce fluctuations in their export receipts, net of the amounts of transactions under the facility, the Fund now recommends that members repay after the end of each of the four years following a drawing under the facility an amount approximately equal to one-half of any excess of exports over the medium-term trend value of their exports.

The extent of compliance with recommendations of the Conference

21. In accordance with recommendation A.IV.17 of the Conference, the limit for outstanding compensatory drawings under the amended facility has been raised from 25 per cent to 50 per cent of a member's quota. However, the acceptance of that recommendation is not unqualified since it has also been laid down that:

(a) Except in the case of shortfalls resulting from disasters or major emergencies, outstanding drawings may not increase by more than 25 per cent of the quota in any twelve-month period.

(b) Compensatory drawings in excess of 25 per cent of quota will be granted on stricter terms than those applicable to compensatory drawings below 25 per cent of a member's quota in that they will be granted only when the Fund is satisfied that the member has been co-operating with the Fund in an effort to find, where required, appropriate solutions for its balance-of-payments difficulties.

Thus, the extent to which the revised facility represents in this particular aspect an improvement over the Fund's past practice depends on the manner in which condition *(b)* referred to above is interpreted.

22. The Fund agrees that there is much to be said for extending the limit of the facility from 25 to 50 per cent of quota. However, it was not prepared for an outright extension of the compensatory tranche to 50 per cent of a member's quota, as recommended by the United Nations Conference on Trade and Development, partly because it feared that since the adoption of this practice would involve an addition to the amount of liquidity which the Fund provides on relatively liberal terms, this might tend to reduce the willingness of countries to have recourse to facilities of a more strictly conditional character. Moreover, the Fund also took into account the effect that an outright extension of the compensatory

tranche to 50 per cent of a member's quota might have on the Fund's own liquidity.[14]

23. The Conference's recommendation that compensatory drawings be placed entirely outside the structure of the gold and successive credit tranches, has been accepted by the Fund in full.

24. As regards the refinancing of compensatory financing obligations recommended by the Conference, the Fund points out that:

> "While there is no specific provision in the Compensatory Financing Decision of 1963 for refinancing of compensatory drawings, refinancing on a short-term to medium-term basis would, in effect, be possible in the circumstances that appear to be envisaged in the UNCTAD recommendation, viz., in the case where at the time when a repurchase falls due in the fourth or fifth year following a compensatory drawing there is a shortfall in export receipts beyond the control of the affected country. The repurchase would restore the compensatory financing facility *pro tanto*, and if at that time an export shortfall of the type described persisted, the member would be in a position to apply for a new drawing under this facility".[15]

Moreover, it is considered that the recommendation on repurchases out of export excesses, to the extent it is implemented, should reduce the likelihood of a repurchase obligation arising at a time of an export shortfall. However, this would not hold if export shortfalls persist for at least four years in a row or where a shortfall is followed by three years without export excesses and then by other shortfalls. The Fund considers that "where such circumstances occur there may be need for basic and long-run measures to restore the exporting power of the country or to ensure satisfactory growth of the market value of its exports".[16]

25. The Conference had also requested that IMF, in its determination of the shortfall in export receipts, consider giving greater weight to the actual experience of the three preceding years. The Fund agrees that a formula giving equal weight to each of the three years preceding the shortfall would have led, over the period 1951 to 1964, to somewhat larger drawing entitlements than the present formula.[17] However, the Fund considers that "the 'performance' of the scheme (as measured by the degree to which compensatory drawings and repurchases bring export availabilities closer to the true trend value, and the degree to which they tend to smooth out export availabilities) would not have improved, but if anything, worsened by such a change in the formula".[18] In any case, in the operation of the revised facility, less weight is to be placed on the statistical formula and more on export forecasts in the calculation of export shortfalls. This makes it possible to take some account of the rising trend of exports in calculating shortfalls.

26. The UNCTAD Expert Group on International Monetary Issues had recommended that the criteria for determining shortfalls be given further study, taking into account the effects of changes in the terms of trade. The Fund facility is not presently designed to take into account the effects of changes in terms of trade. The Fund concedes that "there are undoubtedly good economic reasons for compensating not the money value but the real value, or importing power, of exports".[19] However, the Fund felt that difficulties would frequently be encountered where the import price indices of developing countries were unavailable, unreliable or late in appearing. Estimates on the basis of export or import price indices of industrial countries would not be a satisfactory alternative because developing countries experiencing the largest fluctuations in import prices are substantial importers of primary products, often from developing countries. Apart from such cases the import price indices of primary producing countries do not, as a rule, show very large movements within a short period of years. For all these reasons, it was considered better to adhere to the principle of compensating for shortfalls in export proceeds.

The actual use of the Fund facility

27. Between its introduction in February 1963 and the revision in September 1966, only the following three countries made use of the Fund facility for compensatory financing of export fluctuations: *(a)* Brazil in June 1963, to the equivalent of $60 million; *(b)* the United Arab Republic in October 1963, to the equivalent of $16 million; and *(c)* Sudan in June 1965, to the equivalent of $11.25 million. Thus the total compensatory drawings amounted to only $87.25 million. The infrequency of use was at least partly due to the fact that export earnings of developing countries showed a generally upward trend during this period.

28. Since the amendment of the compensatory facility in September 1966, compensatory drawings have tended to increase. Thus up to mid-September 1967 the following seven countries had made use of this facility to offset temporary export shortfalls, the total drawings amounting to about $102 million; Ceylon in March 1967, equivalent of $19.50 million; Colombia in March 1967, equivalent of $18.90 million; Dominican Republic in December 1966, equivalent of $6.60 million; Haiti in August 1967, equivalent of $1.3 million; Ghana in December 1966, equivalent of $17.25 million; New Zealand in May 1967, equivalent of $29.90 million; and Syria in September 1967, equivalent of $9.50 million. Less favourable tendencies in the export earnings of primary producing countries over the past year of so have probably contributed to the greater utilization of the facility.

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[14] IMF, *Compensatory Financing of Export Fluctuations: A Second Report by the International Monetary Fund*, *op. cit.*, pp. 18-19.

[15] *Ibid.*, p. 27.

[16] *Ibid.*

[17] *Ibid.*, p. 9.

[18] *Ibid.*

[19] *Ibid.*, p. 12.

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