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CHANGES IN AID STRATEGY*

by

Gustav F. Papanek

He who attempts to discuss the future of aid, and to suggest possible new approaches, plows a well-worn furrow. The ideas have been turned over and over and little that is very new has emerged in the last few years. Yet the outlook for economic development depends to a considerable extent on the outlook for aid and the outlook for aid, whether projected on the basis of past trends or by consulting wise men, is dim indeed. It may be worth asking one more time whether a change in strategy is desirable, both for donors and recipients, to take account of changes in aid environment that have taken place in the last few years: the stagnation in absolute levels of aid, the increased efficiency and effectiveness of some major aid receivers and the increasing difficulties of some major aid donors.

The New Environment

Levels of Aid

That the net outflow of resources for development from the rich countries to the poor has reached a plateau recently is widely recognized. Various official compilations confirm this.

*I am grateful for the assistance of S. Guisinger and the critical comments of Lester Gordon, Walter Falcon and Stephen Guisinger. They produced a considerable change in parts of the argument.

Table 1

The Trend in Capital Transfers

from the Developed to the Less Developed

(billions of dollars - net of repayments)

	1960	1961	1962	1963	1964	1965	1966
1. DAC members - public							
a.) Official - bilateral	4.3	5.3	5.4	5.7	5.5	5.8	5.9
b.) Multilateral	.2	.2	.4	.7	.8	.9	1.0
2. Non DAC members - public	.4	.5	.6	.6	.5	.5	(.5)
3. Private	2.8	3.0	2.2	2.4	3.1	3.8	3.4
Total	7.7	9.0	8.6	9.4	9.9	11.0	10.8
4. Interest DAC members only-public, bilateral				-.3	-.4	-.5	-.5
5. Vietnam (South)				.2	.2	.3	.5

( ) is provisional

Source: OECD, Development Assistance Efforts and Policies, 1967 Review (Paris, 1967)

Yet these figures still overstate the real resources actually made available for development. The less developed countries are paying rising interest charges which need to be subtracted from net resource flows. Assistance to Vietnam, which has increased from $200 million in 1963 to $500 million in 1966, is of course included in capital transfers, although little is for development as usually defined. Some of the increase in private investment has gone to a few oil-rich countries, such as Libya, whose affluence is no substitute for the declining resources going to the really poor countries. From 1963 to 1966 (projected) U.S. private investment in petroleum has increased by $450 million.* Taking account of interest charges, and the flows to Vietnam and the oil-rich, the net monetary flow of resources has remained essentially stagnant in the last three years.

The outlook for 1968 and the next few years is discouraging. Appropriations for the fiscal 1968 U.S. aid program, by far the largest component in the resource flow, are down $1 billion compared to fiscal 1965 and 1966. The multilateral organizations have gradually used up their large backlog of accumulated funds, as disbursements in the last four years have consistently exceeded new funds made available. The debt servicing burden will increase at the same time.

The existing and prospective monetary flows need to be deflated to arrive at real resource flows. Prices of manufactured exports from the developed world have increased 5% between 1963 and 1966, reducing the real value of aid by roughly the same amount.** Tying procurement to specific countries has raised prices further. An estimate by

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* U.S. Department of Commerce "Survey of Current Business", September 1966.

** United Nations, "Monthly Bulletin of Statistics" December 1967. (Special Table D).

Mahbub ul Haq for Pakistan suggests that the cost of tied aid to that country is over 12%.* If monetary flows since 1963 are deflated by 15% to take account of rising prices and tied aid the real value of resource flows to the less developed has decreased substantially in the last three years in absolute terms. As a percentage of the national product of the developed and the less developed, or on a per capita basis, the decline has obviously been greater.

Effectiveness of Aid Givers

The tendency of several major bilateral aid donors, notably the U.S., has been to attach to their aid program barnacle-like, additional constraints and concerns. The specific laws and regulations to be satisfied by recipients are sometimes serious -- about bidding, project justification, accounting, checking end use, audits, etc. Undoubtedly some regulations have improved the probity and sense of priority of recipients. But all regulations substantially slow down execution and some distort aid programs as recipients try to adjust to the fashions and political requirements of the donors.

Fortunately specific regulations apply particularly to project assistance and their proliferation has been compensated by increased reliance on program aid. Far worse, and affecting all public transfers, is the legislative justification and appropriations process. This process has become more complex and frightening as legislators have become disenchanged with aid, and with mounting demands on the U.S. program from Vietnam and neighboring countries. A great deal of time and energy, often of the very best people in the aid agencies, goes into the justification and appropriation process. In addition the aid agencies have become increasingly concerned

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*Mahbub ul Haq, "Tied Credits - A Quantitative Analysis", Round Table Conference on Capital Movements and Economic Development, July 21-31, 1965, International Economic Association, Washington, D.C.

with their reception in budget bureaus, other government departments, Presidential offices, and, above all, legislatures. They tend therefore to look increasingly at an aid program's ability to pass the bureaucratic and legislative jungle, not to its maximum contribution to development.

The third development reducing the efficiency of aid givers is the increase in restrictions imposed on aid programs. Tying aid to procurement in the donor country, not only raises prices, it also increases administrative complexity. The same is true of hardened terms, especially on the commodities available under the U.S. surplus disposal programs, and the type of project which is acceptable (e.g., it must be in the private sector and it cannot compete with goods in surplus in the donor country). Implicit political restrictions have also been increasingly applied to some countries.

Finally the growing risk associated with aid has introduced inefficiencies. Some countries -- notably India and Pakistan -- are more inclined to aim for foodgrain self-sufficiency even at the cost of higher value crops after discovering that they cannot rely on U.S. supplies. They, and other countries, may prefer to accept an extensive aid pipeline -- in effect idle funds -- in order to obtain a commitment for the total cost of a project.

The picture is by no means all black. The aid administrators of many countries have become more sophisticated. In the 1960's some, especially the U.S., have shifted resources from project to program aid, greatly reducing administrative problems. If the political atmosphere for aid were as favorable now as in the 1950's, the more experienced staffs administering aid in many donor countries could make a much better job of it. But legislative restrictions, and the administrators' reaction to an often critical atmosphere have greatly diminished the effectiveness of aid.

The consequences are that the influence of donors on development issues is reduced per dollar of aid, since some of it is dissipated on political and procedural matters; aid administrators sometimes tend to ignore basic development problems and longer-run programs, since they believe they must concentrate on the presentation and legislative process; and aid programs are less effective, since they are distorted by a process which gives great weight to non-development objectives. In addition, one of the scarcest resources in the less developed countries--its able senior civil servants and economists--are increasingly preoccupied with presentations to donors. Aid aide-memoires have become more and more sophisticated, in part as more of the less-developed countries compete for declining resources. The effort spent in preparing aid requests and justifications--very worthwhile though it is--naturally diverts energies from other activities. (It is not unknown for governments to have 20 to 30 professionals working exclusively on aid matters, with others spending part of their time on aid.) In short, the efficiency of bilateral aid donors and therefore of a given quantum of aid has been severely affected by legislative restrictions and hostility.

This pessimistic view does not, however, apply to the operation of the International Bank and some operations of the IMF. Both agencies were quite conservative in their early years. The Bank concentrated on specific projects, mostly large engineering works--dams, roads, power, railways. It was much concerned with the technical and economic soundness of a particular project, the credit worthiness of a country defined in rather narrow banking terms, and the Bank's image in the international banking community. The IMF restricted its operations largely to the affluent. When it paid attention to the poorer countries it was often primarily to lecture them on the moral and economic virtues of massive devaluation, uniform and freely fluctuating exchange rates, a balanced budget and price stability.

As both institutions established a reputation for respectability and "sound" practices in the developed world, they have become increasingly venturesome and development oriented. The Bank has carried the process a good deal further, notably in its management of consortia and consultative groups for countries like India, Pakistan and Colombia. While it must be concerned with its image in the rich countries, it does not have a detailed yearly legislative process to go through and is constrained by few legal or procedural requirements. It is beginning to expand its loans to fields like agriculture, education and even commodity imports; and it sometimes covers local currency costs. The Bank's analyses for many countries concentrate on the economy, overall plans and economic policies. Its own loans unfortunately remain essentially tied to specific projects, rather than to policies and programs, but the machinery could shift to a broader approach if the necessary support were available from the principal members.

The IMF has been less venturesome, and in some instances is still prone to stress the religion of stability at all costs and by orthodox techniques. But in other parts of the world, most notably in Ghana, Liberia and probably Indonesia, the IMF has been less concerned with exclusively monetary phenomena.

In short, some bilateral programs are suffering from political and legislative restrictions, while the two leading multilateral institutions have somewhat widened their previous, rather limited, horizons.

Efficiency of Aid Receivers

At the same time the efficiency and effectiveness of a number of major aid receivers has substantially increased. The number of less-developed countries is large and there are exceptions to every statement about them as a group. But the number of countries that receive substantial sums of foreign public capital is more limited and within that group two trends have recently improved the quality of economic management and therefore the ability to use foreign resources.

Some countries have benefited from experience, the shock effect of failures and successes, and a general improvement in the civil service. Others have gained primarily from a change at the political level to more pragmatic leadership with greater dedication to development.

The first group includes such major aid receivers as India, Pakistan, Tunisia, Colombia, Turkey, Chile and Korea. These countries have improved their machinery for policy formulation and planning; they have more well trained civil servants, engineers, technicians, economists and other professionals; the number and competence of their private industrialists have increased; and they have learned some costly lessons about managing their economies. The last point may be the most important. These countries are much less likely now to neglect agriculture; to waste substantial resources on prestige projects; to attempt a complete, detailed system of direct controls over private decisions. On a less exalted level most of them have recognized the importance of fertilizer; have learned the cost of many mammoth water control projects with a long construction period, superimposed on a stagnant agriculture; know how to use foreign technicians and consultant firms without delegating policy decisions to them; and so on.

The second group of countries has benefitted from new political leadership, which assigns a high priority to economic matters. Indonesia and Ghana are the outstanding examples. They kx have learned some economic lessons in an extreme form. While it will take them some time to build the widespread administrative and economic competence which the first group has developed over several years, they are likely to adopt rather quickly policies that make economic sense.

There are a few countries that fall in both groups, having both greater competence in economic management and more political support for economic rationality. Colombia is one example.

A large share of the flow of resources for economic development goes to the countries listed above. In 1966 gross official flows from DAC members and multilateral agencies totaled $6.9 billion. Of that amount something between $600 million and $1.3 billion is not for economic development as usually defined but represents economic support extended for political/military reasons. This includes aid to Vietnam and some part of the resources flowing to Laos, various former French colonies and territories ($700 million total) and a few other countries. In addition $300 million is for European countries, other than Turkey. One is left with gross flows to the less developed countries for development purposes of about $5.5 billion. In 1966 of this amount $2.4 billion would go to the countries listed above, $200-300 million more to countries that have been quite efficient users of foreign resources for some time (e.g., Malaysia, Taiwan, Israel) and larger sums to countries that some knowledgeable outsiders would definitely place in the category of countries with a commitment to development and able to use foreign resources efficiently. (E.g., Kenya, Jordan, Brazil, Mexico, Peru, Tanzania, which together received another $600 million). Of the 10 countries receiving more than $100 million in 1966 (except Vietnam), 7 were listed above as clearly in a better position to use aid and two more may be in the same category.

It is clear that a large share of official resource flows have gone to the countries listed above as having improved the effectiveness of their economic management. It is more difficult to demonstrate that the judgment on economic management is justified. Some of the countries listed have demonstrated good performance in terms of some measurable criteria. If a rate of growth in GNP and exports of 5% or more is accepted as evidence of good performance, then over the last few years Korea (South), Pakistan, Turkey and Tunisia at least come close to meeting both criteria. (In addition a number of countries meet these criteria who are not receiving large flows of aid e.g.: Taiwan, Peru, Jordan, Israel and several Central American states.) But one cannot provide convincing evidence for most major aid receivers. Some of the countries have had a recent change in policies or in commitment to development (Indonesia, Ghana, Chile, Colombia) and the new policies cannot have resulted as yet in measurable economic improvement. The two largest aid receivers have suffered from unusual weather (India, Pakistan) in the last two years, which reduces their measurable performance, and Colombia experienced reduced coffee prices. Since it is extremely difficult to obtain quantitative measures of economic management, one can only advance some quantitative evidence and add the qualitative judgment of a number of outside observers: in part because aid has been more closely related to performance in the last few years, in part because countries have gained experience or have governments with a greater commitment to development, the bulk of resources transferred for development are going to countries that were managing their economic resources more effectively in 1966 and 1967 than they did a few years earlier.

These countries are better equipped technically to prepare and evaluate development projects and more likely to use economic criteria in their evaluation. The need for pressure from foreign aid donors to improve preparation and selection of specific projects has therefore declined somewhat.

This does not mean, however, that there no longer is a case for the use of foreign resources to encourage and support a larger and more effective development effort. All governments are under conflicting pressures and are composed of divergent groups. Inevitably the military press for a ~~lager~~ larger defense effort, political leaders advocate low priority projects in their areas, particular ministries champion their own projects, upper income groups oppose greater equality of income and wealth, taxpayers fight taxes to finance development and so on. Inevitably the strength of contending groups is influenced by the magnitude of foreign resources available to a country, the form in which they are available and the sectors which receive them. It therefore seems both feasible and appropriate that those in control of the foreign resources should use them to encourage groups pressing for development rather than other claimants for resources; for greater social justice; and for a more efficient functioning of the economy. (This is not the place to argue the use of aid to exercise "influence" or "leverage." One can note, however, that those who argue that any such use of aid constitutes unwarranted interference in the internal affairs of a country include some of the most noxious dictators and some of the worst exploiters of their own countries -- only if resources are handed to them, to be used to strengthen their own position, is there no interference in their eyes). While leverage provided by foreign resources need no longer focus principally on improving specific aided projects in many countries, it can be increasingly effective in supporting groups pushing for more general development objectives. For instance, instead of using aid to press for a particular project and a particular design, aid can be used to support stronger central review of all projects in the public sector and a sensible tariff structure to screen projects in the private sector.

In short, it is as difficult to prove increased efficiency and effectiveness of economic management, and especially of project management, on the part of the less developed as it is to prove the opposite for bilateral aid programs.

The evidence will have to remain in part impressionistic. But it is a pretty firm impression, substantiated by the policies adopted by a number of countries, and their results. Colombia seems to be well on the way to a set of policies that can stabilize the price level. Ghana and Indonesia have drastically reduced unproductive government expenditures. Pakistan has achieved a 5% rate of growth in crop production, a 15% rate of growth in manufacturing, and a 6% rate of growth in the national product. Any inflow of foreign resources is likely to be more productive in these countries in the future than in the past.

<u>More Aid in Real Terms?</u>

If the three propositions advanced above are accepted one can more persuasively argue the need for a substantial increase in resource flows, rather than the decline which seems ahead. It is hardly worthwhile to make yet one more stab at estimating "aid requirements." Numerous studies have concluded that an additional three to six billion dollars need to be transferred to the less developed to reach "adequate" rates of growth, with adequacy defined differently by different authors. Anyone not convinced by these attempts will not be convinced by another such exercise.

Most of these exercises have focused on aid "required" -- on certain assumptions about internal savings, foreign private investment and capital/output ratios -- to attain a rate of growth in per capita income which is assumed to be given by political or moral requirements. The new environment in which aid operates has added two further and related reasons for increasing resource flows. First, if most of the principal recipients have a substantially increased ability to use capital, increased resource availabilities would not be accompanied by a rapid decline in its productivity. This in turn supports the second argument: that the total flow of real resources required by the less developed will be minimized if aid is shifted from the far to the near future. While more elegant proof of this proposition has been provided, it is plausible that a country will require less aid to achieve a given increase in income the earlier the aid is provided, as long as the returns from aid (in terms of possible savings or foreign exchange benefits) exceed its cost to the receiver. If aid receivers as a whole have become more efficient, the productivity of aid has increased and a rapid increase in its quantum over the next decade can greatly advance the time, devoutly looked forward to by both donors and recipients, when aid flows can sharply diminish.

Short-term Aid Policy

Much, but not all, of the above descriptions of needs and circumstances is widely accepted among those concerned with development and aid. In some circles of that fraternity an attractive but dangerous package is emerging for dealing with the situation in the short run, when stagnation or a decline in resource transfers is postulated -- reliance on a multiplicity of multilateral institutions and on private investment.

Proliferation of (Multilateral) Institutions

Under present circumstances, the establishment of new aid organizations, particularly multilateral regional banks, is seductively attractive. In the developed countries new agencies with "dynamic, new" programs and approaches seem to appeal to legislatures more than their older and therefore less glamorous sisters. Besides, the multiplicity of agencies produces the appearance that the aid program has declined, since some agencies are separately funded. Multilateral agencies have the added bonus attraction that they give the impression of burden-sharing, with contributions from developed and less developed countries.

Recipients also like multilateral agencies, and especially regional ones, since they are heavily represented in the management. This makes multilateral regional agencies appear preferable to bilateral programs and to the Bank and Fund, since the latter's powerful management is clearly dominated by the developed countries.

The result has been three major regional banks and proposals for additional regional or functional multilateral lending organizations. But there are serious dangers in continuing along these lines. It is highly unlikely that the proliferation of organizations will continue to produce an increase in the flow of resources. Before long budget bureaus, legislatures and other sharp-eyed skeptics will catch on to the game, if they have not already. Shortly thereafter, deciding that new organizations are a device to hide appropriations, some donors and especially the U.S., the prime devotee will realize that the "burden-sharing" aspects have also been oversold. Developed countries have often funneled funds through new multilateral organizations rather than through existing programs without increasing their total contribution.

Moreover, the proliferation of organizations complicates aid administration on both sides. The receiving countries face increased administrative and negotiating problems; they need to prepare another set of justifications, satisfy another set of criteria, and accommodate to another administrative system, forms, procedures and human beings. The new institutions need good staff, and further denude the less developed countries of their best people in a frantic attempt to attract a competent multinational group, largely drawn from the region. On the whole, new regional organizations find it difficult, if not impossible, to match the competence of the better established, more prestigious and much richer international organizations.

Most serious is that regional institutions, and any new small multilateral aid organizations, exert little useful influence on the less developed countries. With limited funds, limited staff, limited maneuverability and leverage, they concentrate on project lending. Limited maneuverability is probably most serious. The regional banks, and similar institutions are dominated by recipients not donors. Under the circumstances it is difficult to discriminate among borrowers, to set up firm criteria of "self-help," of "social progress," of "sensible" economic policies. In any institution whose policy is in the hands of those who must look to a small constituency, the inclination will be to engage in "log-rolling," to devise a simple allocating principle that gives everyone an equal share by some acceptable criterion. To the extent that these agencies do exercise judgment an‹ discriminate

it is on the basis of projects, rejecting those that are obviously poor in technical or economic terms. But in appraising projects they are not likely to be significantly better than the recipient countries, given the difficulties of attracting a good staff and the need for political compromises. On the really crucial issues of development, on the size and strategy of the development effort and major policy decisions, these institutions are not likely to exert much influence. Their resources are too small and their influence cannot be adequately focused given their diffuse control. On the contrary, the multiplicity of agencies, the dispersion of resources among them, and the project approach inevitable for many, makes outside support for major changes in the less developed countries more difficult to mobilize. If important decisions on tax reform, on foreign exchange rates, or on import liberalization, are not taken by some countries because a further proliferation of agencies has made it difficult to put together a suitable package of assistance to support these decisions, it could be an excessive price to pay for the moderate increase in resources resulting from the establishment of further aid bodies.

Private Investment

The other "solution" advanced to cure the inadequate resource flow to the less developed is a sharp increase in private investment. This increase is to result from pressure on the less developed countries to offer better terms and by subsidizing interest rates, insurance premia and exploratory costs.

Undoubtedly, such measures can increase private investment, but there are serious obstacles to a major increase, often called a "quartum jump" in an attempt to give economics an aura of the precision of physics. Subsidies can help, but their effectiveness depends on the state of the capital market in the developed countries and on the state of mind of their investors. When capital is tight and there are ample investment opportunities in the developed countries, investors will think twice before they commit scarce funds and even scarcer top management to less developed countries, even if interest or other costs are somewhat lower. More important, it is difficult to assume or subsidize some of the real risks of investment in these countries -- lack of foreign exchange to import raw materials; delays imposed by the government machinery; lack of power or transport; and so on. For instance, recently investors have been worried about instability in Nigeria and economic recession in India. In the future some countries will look better to private investors, some will look worse. Undoubtedly, some less developed countries could obtain a substantial increase in foreign private investment in some fields (e.g., for fertilizer production in South Asia), but if the evidence of the last 15 years is any guide, large increases in the flow of private investment to most of the less developed countries are unlikely. And the countries who most need capital are least likely to get private investment, since they are generally very poor and with an uncertain outlook.

Equally important, there are severe political limits on a sharp increase in private investment. The bulk of private capital moves only into units controlled by foreign firms and all countries, not just the less developed, are simply not willing to accept foreign control of a large sector of their economy. There are very few places left in this world where a government will long stay in office if it accepts widespread foreign economic control. To try to force a change in the attitude of existing governments is a very shortsighted policy for developed countries. Most governments will resist and the only consequence will be friction. Some will respond to pressure, and are likely to be followed shortly thereafter by another government, which will be quite hostile since its campaign for office will have included a substantial dose of foreign-investor-baiting (vide Argentina, Peru and Cuba, and, to a lesser extent, India and Brazil).

Certainly various schemes for increasing the flow of private investment, with suitable safeguards for both parties, are desirable and will have some results, but these are likely to remain limited.

<u>The Use of Hard, Short-term Money and Debt Rollover</u>

In the next few years any real solution will involve serious risks. It will involve steps that a decade ago were frowned on by all right-thinking economists: debt rollover, suppliers credits and the acceptance of IMF and hard loans, on near-commercial terms. Right-thinking economists were right in inveighing against these devices a decade ago, but the situation has changed.

In the past such methods of transferring capital involved a minimum of guidance and supervision by creditors. The result often was a waste of the capital on unnecessary imports, prestige projects or other ill-considered investments. With increased self-discipline, competence and commitment to development on the part of major less-developed countries, the absence of control by the developed countries over the specific use of foreign exchange is in many cases no longer a drawback but an asset. The less tied the funds -- to procurement in particular countries, to use for investment or to particular projects -- the more effectively they can be used for the most productive purposes.

The increased productivity of foreign exchange in many major countries also greatly weakens the other major argument against heavy reliance on hard loans -- the danger of an excessive debt burden. A decade ago suppliers credits were the bane of many economists' and planners' existence. The goods financed by suppliers credits were often exorbitantly priced, and their usefulness was limited by ignorance, inefficiency and waste. By the late 1960's the more experienced less developed countries have become quite skillful at shopping, and can sometimes get suppliers credits at little real cost in terms of higher prices (When competition is very keen, suppliers credits on occasion are even a device for hidden price cuts, similar to the trade-in allowance on old cars.) At the same time, free foreign exchange is now often used not for low-return investments to operate existing investment closer to capacity. Given sensible policies, ever dollar of foreign exchange made available, and used for raw materials and intermediates, can assure that more than one dollar of exports are earned or impo are saved. In these cases, hard loans, including suppliers credits, are no. the first step on the slippery slope to bankruptcy, but carry with them the seeds of their own liquidation. When a country, like Pakistan, is increasing export earnings at 8-10% per year and could step up exports further if it had more forei exchange, it can easily incur additional debts over a few years. It makes little sense not to borrow more whenever this increases foreign exchange earnings more than debt servicing costs, while simultaneously speeding up development.

(Note the caveat "whenever". Clearly there are still a goodly number of countries with policies that would result in the use of foreign loans for increased consumption, not increased exports or import substitution).

The risks of borrowing are reduced further if one expects that resource flows to the less developed countries are likely to increase again a few years hence. One way or the other the war in Vietnam is likely to end; the U. S. balance of payments problem will have to be brought under control; international liquidity will have to be expanded; the developed countries will again achieve a higher average rate of growth. For all these reasons a greater flow of resources to the less developed is quite possible. It would be serious if in the meantime development were not vigorously pushed -- momentum will be lost in the less developed, political problems will mount, the developed countries will become further discouraged about development possibilities. The result may be permanent acceptance of a low rate of growth in the less developed countries, accompanied by low resource transfers to them from the developed. On the other hand, if some of the crucial countries achieve a rate of growth of 5-7% in national product for the next few years -- a rate which is quite feasible -- there is a good chance that their rising foreign exchange earnings, decreasing import needs and increasing capital inflows would make their new debts easy to bear.

Of course there remains some risk in increasing recourse to hard money. It is possible that less developed countries will need to meet their heavy debt commitments some years from now with no increase in aid. The only solution for some countries may be massive debt renegotiations or, as a last resort if this is not acceptable to the creditors, default. Even this ultimate way out would hardly be novel; a good many developed countries have failed to pay their debts. This is not to argue that default would be painless. But in the immediate future the alternatives for many countries are additional borrowing on hard terms or a cut in their output and development program. The unfortunate consequences of reducing output and development would be sure and immediate. On the other hand, a greater indebtedness may not create a serious problem if exports (or import substitution) are pushed vigorously or if resource flows to the less developed increase in the future. If neither happens, renegotiation could be a second best alternative, default a last resort. The serious effects of a reduction in the growth rate are sure and immediate; increased indebtedness involves the possibility of future risk. A choice should not be too difficult for many countries.

Countries that opt for heavy indebtedness can greatly reduce the risk if they use the additional resources obtained by borrowing to reduce their future dependence on aid. If increased foreign borrowing takes the form largely of short-term debt, as it must under current circumstances, these countries will encounter a sharp increase in their debt servicing costs about a decade from now. At that time the debtors' position in any renegotiations would be much strengthened, and default would be a realistic alternative, if they have achieved a balance in their foreign accounts without the need for net extraordinary capital flows; that is, if their foreign exchange earnings cover the foreign exchange required for continued operation and minimum acceptable growth without either aid or debt service. In that case the creditors face the choice of (i) providing enough new resources to cover debt service, or (ii) reducing the debt servicing burden by renegotiation, or (iii) accepting default, with little power to retaliate. On the other hand, if the debtors require foreign resources above the amounts necessary for debt servicing, their position would be a weak one. Default would not be a creditable threat since the creditors could retaliate by cutting off all aid, which would force a reduction in imports even if debts are not serviced. One or two less developed countries have recently found themselves in just this position, and were forced to continue servicing some pretty doubtful debts in order to obtain the net inflow of resources they badly needed. Therefore increased short- and medium-term borrowing should be used to achieve one primary objective -- to step up export earnings (or reduce import requirements). The National Product would rise more rapidly at the same time but the foreign resources should not be allocated to maximize this growth, but to minimize the foreign exchange gap. If potential debtors can eliminate the need for net extraordinary transfers some years hence, the risk of increased borrowing would be quite acceptable -- and at an 8-10% rate of growth in exports accompanying a 5-6% rate of growth in GNP and imports, which have been achieved by several countries and are achievable by others, it should be possible for a number of countries to eliminate the foreign exchange gap in the foreseeable future.

If these arguments are accepted, there is considerable scope for increasing resource flows to the less developed countries. The first method is a selective debt-rollover. A near-universal debt moratorium would not be acceptable to the creditors and would be undesirable, since it would assist principally those previously -- and perhaps currently -- improvident, rather than those able to use foreign exchange most effectively. But a number of countries that are prime candidates for more resources face a considerable debt burden -- notably Colombia and India, with the latter's debt servicing $350 million this year and rising thereafter. Furthermore, money is fungible and by rolling over the debt of some Latin American countries, instead of providing an equivalent amount of new loans, funds can be diverted to other areas with a small debt. Without going to extremes, the flow of real resources could be increased temporarily by $500 million or more by debt rescheduling. Since no appropriation of funds is required such rescheduling presents fewer problems than an equivalent amount of new loans.

Suppliers credits can quickly provide substantial resources with great flexibility. Fierce competition for exports among the developed countries can be used to obtain satisfactory terms. There would be less danger of abuse than in the past if arrangements are made by private firms who assume the debt, and if foreign exchange is not as seriously undervalued by the country obtaining the credit.

Greater resort to the World Bank is quite feasible. The Bank can obtain additional funds, but has been reluctant to expand its loans to some countries -- notably India and Pakistan -- because it feared their ability to service debt was exhausted. This conclusion assumed that exports would increase at best by 5% or so per year. Clearly, if exports rise more rapidly, and if a greater flow of soft loans is expected in a few years, the debt ceiling should be raised.

The IMF represents another underutilized resource, especially if the problem is expected to last only 3-5 years. Interest charges are low and the IMF could make available several hundred million dollars. Some of the less developed countries have to overcome their reluctance to use the IMF, because they regard recourse to it as a symbol of failure in monetary management. The IMF in turn would have to depart further from orthodox theology and a preoccupation with primarily monetary criteria.

The final, and most promising source of additional funds is the

Export-Import Bank of the U.S. and similar institutions elsewhere. These organizations do not require appropriated funds, they can provide longer and better terms than the usual suppliers credits and they are responsive to their governments. Under present circumstances there is no good reason not to expand their lending operations considerably. The Export-Import Bank alone could provide several hundred million dollars annually to the less developed countries.

As long as short term and hard loans are acceptable, the multilateral organizations and the executive branch in the developed countries, most notably in the U.S., have the ability to increase the flow of resources to the less developed over the next 2-3 years by one to two billion dollars, even if the Vietnam war and other factors make it doubtful that aid appropriations or private investment will increase significantly. To achieve such a flow the less developed countries would have to accept the risks of greater indebtedness. The developed, and the multilateral organizations, would have to change their policies, especially against further borrowing on hard terms by some countries.

Longer-Term Aid Policy

Hard loans can, however, not be relied on for more than a few years, or they will impose a serious drag on development. As the loans provided in an initial spurt fall due in a few years, the need for further loans will escalate. Yet, even with the excellent performance which is feasible, the need for capital flows to the less developed countries will not begin to decline in absolute terms for the next 10 or more years if desirable growth rates are to be achieved. Debt renegotiation or default should be a final fallback position, not the objective of either developed or less developed. Nor should they be satisfied with a minimum acceptable level of growth. Once a better atmosphere for increased resource transfers exists, there should be a renewed shift to longer-term, lower interest loans and some grants.

If the argument so far is accepted, the nature of a longer-term aid program for those countries with reasonably efficient economic management suggests itself -- it should provide for a greater transfer of resources than is currently possible; it should have a minimum of restrictions on terms, procedures and administrative arrangements; it should largely ignore the specific uses to which funds will be put: the projects or the imports financed; and it should provide maximum support on overall development issues: the level of investment, the strategy to be followed and major economic policies.

This means that aid programs have to be substantially divorced from the legislative process; have to be administered by agencies with a high degree of professional competence; if possible, should be administered by agencies not influenced by short-term political considerations but able to relate resource transfers to overall development issues; and whose influence on major policy issues is reasonably acceptable to the less developed countries. These requirements can be met by aid that is a by-product of international monetary reform and is channeled through the World Bank.

Aid and Monetary Reform

The notion that international monetary reform can provide massive resources for the less developed may appear fanciful now. The various plans for doing so seem to be dead, discussed as little by government officials and academics as by the Group of Ten. But the pressure for increasing international liquidity is bound to become irresistible before long. The concern with development and the demands of the less developed are likely to grow. The real resources available for transfer to the less developed will simultaneously increase rapidly. Since serious depressions in the West are a thing of the past, a continuous increase in GNP of two to five percent per year would, in the absence of war, greatly reduce the real burden of the present assistance effort. The combined effect of these factors should make it possible to reactivate various plans for combining liquidity and aid. Some proposals may not require legislative approval in the developed countries. Those that do may have a better chance than plans to finance institutions like IDA, first because they would greatly benefit the developed, not just the less developed, and second, because they would not involve a well-understood and long-criticized "aid appropriation," but a desirable and complex "monetary reform."

These points require amplification. The current programs for transferring resources, of course, involve largely the normal budgetary process. This means they are financed out of tax revenues and have visible political costs. It also means that expenditures have to be surrounded with all the safeguards normal for funds appropriated to governments of the developed countries. Both the appropriation and expenditure process suffer from middle age malaise which often affects government programs -- concern with costs and administration -- especially since aid programs have no constituency that can provide effective support.

Various alternatives have been proposed to increase resource transfers to less developed countries. Greater access to the markets of the developed is now in vogue, as are commodity agreements to raise prices of some products exported by the less developed. Both have the advantage that they do not require yearly legislative review and appropriation, and complex administration. Both suffer from two serious defects. First of all they have clear costs for powerful groups in the developed countries and therefore arouse strong opposition. It does not seem very likely, for instance, that a sizeable increase in textile imports will be acceptable to developed countries, or that they would exert strong efforts to raise the prices of tropical products by a substantial amount. Second, both measures would have a differential impact on the less developed countries, assisting those producing commodities in whose favor discrimination is exercised, without any necessary relationship to the development effort the beneficiaries are undertaking. Whatever can be done to improve the terms on which the less developed export to the richer countries is all to the good, but it is unlikely to provide the major share of the increased resources they require.

Resources provided through monetary reform, in contrast, are costless to the developed countries. It should be easier to convince governments in developed countries to forego a small part of the massive benefits from monetary reform than it is to accept the obvious costs of appropriated aid funds, or tariff concessions or higher prices. Resource transfers via monetary reform also are easier because they are much more in the hands of technocrats than of legislators. One only has to contrast the ease of swap arrangements between central banks, an important resource transfer, with the problem of aid transfers to appreciate this factor. If the civil servants and central bankers of the developed countries were convinced, for instance, that an international reserve unit should be created by the IMF and transferred to less developed countries they should face fewer problems in getting this accepted than an equivalent transfer of resources via appropriated funds, lower tariffs or higher prices for imports.*

In any case this is not an either-or proposition. The less developed countries, and those concerned with development elsewhere, can continue to advocate greater aid flows, trade preferences and commodity agreements but one can doubt that progress in all three directions will be adequate to meet the need for resource transfers. Some arguments have been advanced to suggest that monetary reform is a promising additional source of funds. So far it is a source that has been rather neglected. It could be very much worthwhile for the less developed countries and their friends to press as hard for resource transfers through monetary reforms as they did for transfers via lower tariffs.

Aesthetically and professionally the most satisfying, and most effective transfer of resources in the course of monetary reform would be any variant of the proposals for a complete shift to an international reserve currency, with all of the new purchasing power going to the less developed

*At least the Subcommittee on International Exchange and Payments of the Joint Economic Committee of the U.S. Congress advocates the use of any new international reserves to augment the flow of resources to the less developed countries (Report of December 1967, "Guidelines for Improving the International Monetary System, Round Two").

on the basis of some general criteria. As the world economy expands there would be an automatic transfer of resources roughly proportional to the rise in international trade.

But other designs for increasing international liquidity can have similar beneficial effects for the less developed. Even a revaluation of gold can be used to provide resources. An international agreement could assure that the paper profits made by most developed countries on their gold stocks are transferred over 5-10 years to the less developed countries. This would have the additional advantage that countries which supported the existing international monetary system by not converting their reserves into gold would not be penalized. It might therefore be made a condition by the U.S. to any gold revaluation.

Any combination of a higher price for gold and a new reserve currency could, of course, also provide resources to the less developed. So could increased drawing rights on the IMF, though this would be more complex. It would require that drawing rights for the less developed countries be increased gradually, at a defined annual rate and that some parts of these rights would in effect represent permanent credit. The IMF would be the creator of a new reserve currency -- or rather a new reserve credit system, with initial credits going to the less developed.

All of the comprehensive proposals advanced by various economists over the last decade may be too extreme, given the conservative nature of the international financial and banking community. Some 20 years passed from the time that Keynes' ideas were widely accepted among economists before they became general policy. Even if everything has speeded up in the last few years, it may be another decade before the more rational, but also more radical, notions for an international monetary system are accepted. Partial steps can help in the meantime. It has been suggested that a limited number of developed countries could establish their own, limited, credit system, automatically extending loans to each other, combined with a commitment to hold each other's currency and eschewing conversion to gold. In effect, they would be creating a limited international reserve credit system. This idea could be extended by an agreement to provide loans as well to less developed countries, funded by central banks, export-import banks and other institutions that do not rely on appropriated funds. These loans could be, in effect, inter-bank credits, going to the central bank of recipient countries, at very low rates of interest, and with no fixed term. They could be "tied" to procurement in the countries participating in the agreement, This would largely eliminate the possible adverse balance-of-payments effect on the group of creditors. As a matter of fact, it might well improve their position if the group is strong enough, since there will be a natural tendency for the less developed countries to shift their free purchases to a group of countries with whom they have close economic relations as a result of the large flow of resources under the credit scheme.

Control, Management and the World Bank

Whatever device is used to increase the flow of resources to the less developed, if it is not a bilateral flow and is therefore not tightly controlled by the individual creditor country, some mechanism will have to be devised to channel the flow to particular countries and for particular uses. One can advance unconventional ideas, but one would be stretching credibility too far to suppose that the U.S. would participate in any scheme that funnels substantial resources to Castro's Cuba or Mao's China; or that the U.K. would have welcomed a proposal to prop up Sukarno's confrontation of Malaysia or to help finance the UAR's intervention in Yemen. Nor would it have made much sense to provide resources to enable Bolivia to avoid taxing its rich while subsidizing its tin mines, or to enable any number of countries to increase their armaments to pressure their neighbors, or to build monuments to the ruling group. Furthermore, at least some countries now insist that any scheme for increasing international liquidity provide safeguards against "reckless policies" and "improvident" expenditures on the part of the U.S. and U.K. Such countries are not likely to accept a scheme that does not have the same safeguards with respect to the less developed countries, who would not bear the burden of the scheme and some of whom are not notorious for conservative monetary policies. To put it another way: at the very least, resource transfers need to distinguish among countries and among groups within countries in order to assist those countries and groups which emphasize development, provide a minimum of social justice and follow policies that assure minimum standards of economic efficiency.

Clearly the management of the resource flow could not be left to any bilateral arrangements. It would be difficult to transfer funds from a multilateral monetary arrangement to bilateral control, and few less developed countries would accept such bilateral arrangements. The IMF has to be much too concerned with stabilization and the management of the international monetary system to be suitable as the manager of a development effort. The World Bank would be the logical existing institution, though a new institution with similar attributes could also be established.

Since the institution would be charged with managing large sums of money, it would need to have the confidence of the developed countries, who would provide the resources while relinquishing any direct control over them. It would be equally important for the less developed countries to have confidence in the institution and some assurance that it would not be subject to continuous political influence from the developed or log-rolling among the less developed. Otherwise most less developed countries would strenuously resist attempts by the institution to influence their economic policies. To obtain the confidence of both sets of countries requires strong and competent management and staff; a reputation for independence; and policies that encourage concentration on the broad, important questions of development -- savings, the size and composition of the investment program and major economic policies -- rather than on particular projects.

The World Bank has a strong staff and management, an asset any new institution could acquire only over time. It also has a reputation for independence, though this is not without some flaws, and has begun to shift from a project to a development orientation. It would be only sensible to strengthen the Bank and its affiliated units, rather than develop a new organization, which will take years to reach the Bank's present competence and reputation. If the Bank were asked to handle resources much greater than at present, with economic development and sensible overall economic management as the criteria of success, it should rapidly be able to move even further from an investment bank concerned with the soundness of individual projects, to a world development bank, concerned with the management of economies.

Summing-Up

It was argued that the environment for aid, or for the flow of resources to the less developed, had changed significantly in the last decade:

1. The effectiveness of some bilateral aid programs has become increasingly circumscribed by legislative restrictions and a critical atmosphere.

2. The effectiveness of economic management in many important less developed countries has increased, as some gained staff and experience, others acquired a political leadership more concerned with development, and some benefitted from both. They still need outside support for policies and programs designed to shift resources to development, to achieve a greater measure of social justice and to improve the overall efficiency of their economies.

3. The resource flow to the less developed has recently stagnated and is unlikely to increase in the short term. In real terms, public transfers have probably declined. With the end of the Vietnam war the outlook may become more hopeful.

Stagnation in resource transfers has contributed to support for programs to increase private investment in the less developed and for a proliferation of multilateral organizations. But the economic obstacles to a sharp increase in private investment are formidable and most less developed countries are unwilling to see a large part of their economy in the hands of foreign investors. Additional multilateral organizations are unlikely to be a good device to increase appropriations and greatly weaken the desirable outside support for development.

In the short run, the solution may lie in debt rollovers and the greater use of loans on near-commercial terms -- from the Export-Import Bank and similar institutions, from the World Bank, the IMF and suppliers credit. The greater competence and potential for higher growth of the less developed makes this path much less risky than a decade ago. It will be in the interest of the borrowers to use the additional resources obtained to reduce their dependence on foreign aid. By the time the new debts create a serious servicing problem the less developed countries would be in a strong position to renegotiate (or to default) if necessary, if they no longer need extraordinary transfers on a net basis.

In the longer run a major hope is that pressure for increasing international liquidity, and pressure from the less developed, will make resources available as a concomitant of steps towards a sensible world monetary system. It may be possible to increase liquidity and channel funds to the less developed even before a fully-managed, near-universal world monetary system is achieved. It would be desirable to leave management of the additional resources to a strengthened World Bank, charged with allocating them to countries with good economic management, not primarily to those with good individual projects.

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