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Selected Papers

The President's Task Force on International Private Enterprise

FOREWORD

The Task Force on International Private Enterprise commissioned a number of research papers and studies relevant to its work. It also received contributions from interested experts, various U.S. Government agencies, and multilateral institutions. This volume of the Report of the President's Task Force on International Private Enterprise includes selected papers used by the Task Force in its deliberations.

December 1984

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ABBREVIATIONS

ACTN	Advisory Committee on Trade Negotiations
AFGRD	African Graduate Program
AID	Agency for International Development
APAC	Agricultural Policy Advisory Committee
APED	Panamanian Association of Business Executives
BFCE	Banque Francaise du Commerce Exterieur
BHN	Basic Human Needs
CCC	Commodity Credit Corporation
CESA	Center for Graduate Studies in Management
CIP	Commodity Import Program
COFACE	Compagnie Financiere de la Cote d'Ivoire
COLAC	Latin American Credit and Loan Company (Panama)
DAC	Development Assistance Committee
DITI	Department of International Trade and Industry
DLF	Development Loan Fund
DREE	Direction des Relations Economiques Exterieur
ECGD	Export Credits Guarantee Department
EDC	Canadian Export Development Corporation
EEC	European Economic Community
EID	Export Insurance Division
Eximbank	Export-Import Bank
FANA	Food Aid Needs and Availabilities
FAO	U.S. Food and Agriculture Organization of the U.N.
FBC	Foreign Business Corporation
FOV	Federation of Voluntary Organizations
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
ICI	Intermediate Credit Institution
ICICI	Industrial Intermediate Credit and Investment Corporation of India
IESC	International Executive Services Corporation
IFC	International Finance Corporation
IIDI	International Institute for Development, Inc.
IMF	International Monetary Fund
INCAE	Central American Institute for Management
IPAC	Industry Policy Advisory Committee
ITA	International Trade Administration
JACC	Joint Agricultural Consultative Corporation
KOTRA	Korean Trade Promotion Office
LAAD	Latin American Agribusiness Development Corporation
LAC	Bureau for Latin America and the Caribbean (AID)
LASPAU	Latin America Scholarship Program for American Universities
LDC	Less Developed Country
MITI	Ministry of International Trade and Industry
NBS	National Bureau of Standards
NESA	Bureau for Near East (AID)
NIC	Newly Industrialized Country
ODA	Official Development Assistance
OECD	Organization for Economic Cooperatation and Development

OLS	Ordinary Least Squares
OPIC	Overseas Private Investment Corporation
PCGP	Productive Credit Guaranty Program
PFP	Partnership for Productivity
PPDC	Philippines Private Development Corporation
PRE	Bureau for Private Enterprise (AID)
PVO	Private Voluntary Organization
ROCAP	Regional Office for Central America Programs
SEAVIC	Southeast Asia Venture Investment Corporation
SENAI	National Industrial Apprenticeship Training Service
SMSE	Small and Medium-Scale Enterprise
SSE	Small-Scale Enterprise
TDP	Trade and Development Program
TFF	Trade Financing Facility
U.N.	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
USDA	U.S. Department of Agriculture
USTR	U.S. Trade Representative
YPO	Young Presidents Organization

I.

DEVELOPMENT

1.

FOREIGN AID, THE PRIVATE SECTOR, AND ECONOMIC GROWTH

By Keith Marsden

FOREIGN AID, THE PRIVATE SECTOR, AND ECONOMIC GROWTH

INTRODUCTION

Does foreign aid help or hinder development? Advocates claim that aid boosts economic growth in poor countries by supplementing their scarce savings, skills, and foreign exchange. Without aid, these countries would either have to cut back on their development programs or finance them by raising taxes or by borrowing more heavily from commercial sources. Higher taxes, they say, would have negative effects on output by increasing disincentives for savings, work effort, and innovation. Further commercial loans, if available, would heighten the burden of servicing debt, which is already onerous. Thus the benefits of aid to the recipients can be substantial. Yet the cost to rich country donors is meager and is more than recouped through expanded trade and greater international security.

These claims are disputed by some conservative critics.1/ Aid impedes development, they argue, because it goes mostly from government to government. Thus it increases the politicization of economic decisions and extends the public sector at the expense of private enterprise. Growth is retarded by the inefficiency and market distortions resulting from excessive government intervention. Furthermore, the critics maintain, foreign grants and subsidies allow governments to persist with poor policies and wasteful projects because they do not pay the full costs of their mistakes. The poor countries would do better to attract direct foreign investment and channel a higher proportion of commercial credit to the private sector, where it would be used more effectively.

Both sides in the debate tend to support their cases by reference to conspicuous country successes or failures. But what is the broader statistical evidence? We have tested various claims using data for a cross-section of 21 countries (see Table 1.1). The countries selected span almost the full spectrum of world incomes and represent a wide range of economic performance over the past decade. With the exception of the United States, the countries are grouped into pairs with similar per capita incomes. Average ratios or rates were calculated for key variables for the ten-year period 1970-1979 to even out the effects of random short-term fluctuations. Statistical (regression) analysis was undertaken to estimate the strength of the links, if any, among the variables. Table 1.1 shows the basic data. Table 1.2 gives the regression results. The findings are summarized below.

Aid/Gross Domestic Product Growth Links

At first sight, the data in Table 1.1 suggest a generally positive correlation between aid and growth. With just two exceptions (Zambia and Uruguay), the countries receiving higher levels of aid than their counterparts also achieved higher rates of growth of GDP. However, the association proved to be weak statistically (see equation 1 in Table 1.2). Aid accounted for less than 1 percent of the variation in growth rates among countries. One possible explanation is that aid/Gross National Product (GNP) ratios were relatively low (below 2 percent) for most middle income countries. But separate regressions were also run on the ten countries with per capita incomes of less than $1,300 in 1979. Although their aid ratios reached as high as 8.8 percent, the direct impact of aid on their growth was also shown to be statistically insignificant. Substantial aid certainly does not guarantee growth.

Two further hypotheses were therefore examined. First, the effects of aid may be overshadowed by domestic policy variables, which are more critical determinants of development. Second, aid may reinforce effective policies but is rarely sufficient to counteract an unfavorable policy environment.

The analysis focused on five policy variables frequently discussed in the aid debate. These are listed below, together with the usual a priori assumptions or hypotheses about their impact on growth.

o Tax levels--expected to have negative effects by reducing incentives and net returns to the principal factors of production.

o Share of the private sector in domestic credit--expected to be positively associated with growth because private firms tend to be more efficient than government and public enterprises.

o Government budgetary surplus or deficit--latter expected to have a negative impact because increased government borrowing "crowds-out" the private sector from the financial markets.

o Direct private foreign investment--advocates predict positive effects by supplementing scarce capital and technological and managerial know-how; opponents predict negative effects because it is said to result in enclave activities with few linkages to the domestic economy and because resource rents are siphoned abroad.

o Debt/service ratio--impact depends upon whether the foreign loans being serviced are used effectively and in ways that enhance output.

Taxes

Taxation is a major policy instrument. The ratio of total tax revenue to GDP indicates the extent to which the central government preempts private income to finance public expenditure. Our statistical analysis suggests a strong negative relationship with economic performance. An increase of 1 percentage point in the tax/GDP ratio was associated with a decrease in the rate of growth of 0.36 percent in the group of countries as a whole. Forty-four percent of the intercountry variance in GDP growth was explained by difference in the overall tax burden (equation 2). For the ten lower-income countries, the estimates were even higher, at -0.57 percent and 66 percent, respectively. The results were significant at the 1 percent level.

A more detailed review of tax/growth linkages has been published elsewhere.[2/] The evidence suggests that tax policy in the countries under study affected economic performance via two basic mechanisms. First, lower taxes resulted in higher real (after tax) returns to savings, investment, work, and innovation, stimulating a larger supply of these factors of production and raising total output. Second, the focus and types of fiscal incentives provided by low-tax countries appear to have shifted resources from less-productive to more productive sectors and activities, thus increasing the overall efficiency of resource utilization (total factor productivity). The reverse seems to be true for some high tax countries. The findings also imply that resources left in the hands of private firms and individuals tend to be used more productively than resources transferred via taxation to public sector programs. This holds for the levels of taxation represented in the sample. It is conceivable that if tax ratios fell below a certain point, essential government services could not be maintained, resulting in a drop in efficiency in the sectors receiving those services.[3/] A study of 104 countries found a negative relationship between the share of total government consumption expenditure in GDP and the rate of growth of per capita GDP during the period 1960-1976. However, there was a positive association with expenditure on education. There might also be welfare losses. However, our analysis revealed no significant differences between high and low tax countries in such social indicators as life expectancy and income distribution.[4/]

Share of Private Sector in Credit

A second major policy variable is the share of the private sector in domestic credit provided by the monetary authorities and deposit banks. This indicator covers both domestic and foreign currency loans channelled through domestic financial institutions. It shows how large a piece of the financial market's pie was available for private enterprises after the borrowing needs of government had been met. Government includes local government authorities and other official entities (such as public enterprises and parastatal bodies) as well as the central government. Thus, this indicator provides a broader measure of the relative size of the public and private sectors than does the tax/GDP ratio.

Table 1.1 shows that, in all cases, the countries that provided their private sectors with wider access to credit realized more rapid growth than did their paired counterparts. The statistical analysis (equation 3) indicates that an increase in the share of the private sector of 10 percentage points raised the GDP growth rate by 0.41 percent. This coefficient was significant at the 1 percent level, and the equation explained 27 percent of the intercountry growth variance.[5/] Similar results were obtained by Mario Blejer and Mohsin S. Khan using unpublished data on investment in 24 countries during 1971-1979. They found that a 10 percent increase in the private sector's share of total investment was associated with an increase in the real growth of GDP of 0.45 percent. When combined with the tax and aid variables, the explanatory value was increased to 58 percent (equation 4).

The findings support the view that the private sector makes more efficient use than government of the financial resources provided to it. Several reasons have been given by analysts[6/]. The private sector tends to have more experienced management, greater competitive stimulus, more entrepreneurial drive, and stronger work incentives and motivations. Public enterprises are subject to tighter political constraints and pressures from sectional interest groups. They are also used for political patronage. They are frequently set social objectives, such as preserving employment and restraining rises in the cost of living, which are difficult to reconcile with efficiency. They are rarely allowed to go out of business, even if their products and plants are obsolete and incurring huge losses. Red tape and excessive bureaucracy sometimes undermine the effectiveness of government services. And a large public sector often coincides with greater indirect government controls over private sector decisions through licensing, rationing, and regulations. Such interventions tend to distort incentives and bring about misuse or misallocation of resources in the economy as a whole.[7/]

The tax and private sector credit variables remained significant when investment and labor inputs were incorporated into equation 5. This was true for the sample of 21 countries as a whole and for the group of 16 developing countries. The explanatory value of the equation was increased to 83.2 percent and 84.5 percent for the two groups, respectively. But the magnitudes of the coefficients for the tax and private sector policy variables dropped, because part of their impact had been absorbed into the input data for investment and labor force growth. Their t-values were also reduced because of intercorrelation among the variables, but still satisfied a one-tail significance test at the 10 percent and 5 percent levels, respectively.

Several studies have shown negative relationships between taxes and investment rates and, to a lesser extent, between taxes and employment growth[8/]. Our analysis suggests that a 1 percent increase in the tax/GDP ratio reduced investment growth by 0.67 percent for the group as a whole and by 1.23 percent for the 16 developing countries. Both coefficients were significant at the 1 percent level (equation 6). A 10 percent increase in the share of the private sector in domestic credit raised investment growth by 0.57 percent for the full sample, significant at the 10 percent level (equation 7).

Robust results were also obtained when the tax and private sector variables were combined with export and aid variables and regressed against GDP growth (equation 8). The estimates for the first three variables were significant at the 1 percent level. The aid coefficient had a positive sign but a weak association with GDP growth. Strong positive links between exports and economic growth have been noted in numerous studies[9/]. However, the growth of exports is not a policy variable itself, but rather the result of particular policy instruments including fiscal incentives and provision of credit[10/]. We estimated that a 1 percent reduction in the tax/GDP ratio increased export growth by 0.40 percent. The estimate was significant at the 10 percent level (equation 9). Our earlier tax study revealed a more significant relationship for foreign trade taxes in particular.

Government Surplus or Deficit

The private sector's access to credit markets may be constrained for two reasons. First, the government may own a large percentage of productive assets and be responsible for a high share of total employment and GDP. Thus public sector requirements for short-term credit for working capital could be substantial just to keep its operations running. Second, the government may need to borrow on a still larger scale to cover deficits on its current or capital expenditure accounts.

Comprehensive data for the share of the public sector in assets, GDP, or employment are not available. We have therefore confined our analysis to the level of the government budget surplus or deficit. The results of equation 10 suggest a strong positive relationship between surpluses and economic growth and hence a negative association with deficits. In our sample group as a whole, an increase in the central government deficit of 1 percent of GDP was associated with a decline in the rate of growth of GDP of 0.61 percent. The estimate was significant at the 1 percent level. The magnitude of the impact was similar in all three groups. The explanatory value of the equation ranged between 37 and 44 percent.

Three factors may account for these findings. First, substantial government borrowing "crowds out" the private sector by raising interest rates. Thus, the most efficient and dynamic segments of the economy (particularly new firms) may be deprived of working capital and investment funds. Second, deficit financing tends to be used to prop up loss-making public enterprises with low economic returns.11/ Third, deficits may reflect heavy government expenditure on free or subsidized services. Although these services may yield significant social benefits, deficit financing may mean that scarce domestic savings are used to augment consumption at the expense of investment, thus retarding economic growth and perhaps social progress in the long term.

Direct Foreign Private Investment

Supporters of direct foreign private investment argue that it stimulates development in the Third World by supplementing scarce technological and managerial know-how, facilitates access to export markets, and provides equity risk capital which does not impose a debt servicing burden on the recipient country. Opponents maintain that it often results in enclave activities with few linkages to the domestic economy and that resource rents are siphoned abroad.

The regression analysis did not provide macroeconomic support for either of these viewpoints. Equation 11a, relating foreign investment to GDP growth, yielded a negative coefficient, but the level of significance was weak and the explanatory value very low. The policy environment appeared to have a critical influence on the outcome of foreign investment. In Singapore, for example, direct foreign investment averaged 7.9 percent of GNP during the 1970s. It took place in an economy with relatively low tax rates, an outward-looking strategy, and a small public sector which was a net lender rather than borrower. A high GDP growth rate was achieved. On the other hand, substantial foreign investment flowed to Liberia and Jamaica in the early part of the decade, but was subject to sharply increased tax rates on mineral exports or was channelled into highly protected import substitution industries. Their growth rates were adversely affected.

Debt Service

The final variable examined was the level of debt service. This is the sum of interest payments and repayments of principal on external public and publicly guaranteed debt expressed as a percentage of GNP. Equations 12a and 12b suggest that it has a powerful negative impact on growth. For the 16 developing countries, a 1 percent increase in the debt service ratio reduced the growth rate by 1.28 percent. The estimate was significant at the 1 percent level and the equation accounted for 45 percent of the intercountry growth variance. The effects were even stronger on the 10 lower-income countries, with a parameter estimate of -1.44 and a R^2 estimate of 0.64.

Three explanations for these results can be offered. First, the higher the level of payments that must be made to foreign creditors, the greater the diversion of domestic resources and foreign exchange earnings from alternative uses that would have contributed to output. The inflow of financial resources that created this debt may not have generated sufficient growth to offset the costs of debt service, perhaps because resources were used on unsound projects or wasteful consumption. Second, large debt servicing requirements tend to accentuate the scarcity of foreign exchange. Allocation systems for foreign exchange often give priority to food imports and public sector needs (including defense), resulting in a shortage of raw materials and spare parts and low capacity utilization in the more productive sectors. Third, as most foreign debt is public or publicly guaranteed, the majority of the loans tend to be used to finance government programs and, to a lesser extent, those of the privileged large-scale private enterprises. Small and medium-sized enterprises, which are often more dynamic and efficient, tend to have more restricted access to the foreign loans and foreign exchange which they need to acquire new technology and other imported inputs.12/

The Impact of Foreign Aid on Policy Variables

Although it does not pretend to be exhaustive, the analysis has identified some statistically significant policies and other variables for explaining growth. When the significant policy variables affecting the whole sample--taxes, government surplus/deficit and the private sector share of credit--were combined in a composite equation (13), the first two variables retained significant t-values and the tax coefficient was particularly robust. However, the significance of the private sector variable dropped, probably because of intercorrelation among the variables. The equation explained 64 percent of the variance in the growth experience. For cross-sectional analysis this degree of explanatory power is high, especially when the components of growth such as investment and exports are excluded. But, at the same time, it leaves ample scope for other factors to play a part. The possibilities are numerous. We examined two--per capita GNP and the share of industry in GDP as an indicator of structural differences. Neither was shown to be significant (equations 14 and 15). Previous studies have considered such factors as country size and changes in the terms of trade, which might have affected mineral exporters in particular. But no significant relationships with growth were found.13/

The final hypothesis considered was that foreign aid affected the outcome indirectly by influencing domestic policies. We tested this hypothesis by regressing the aid ratios against the policy variables. For the group of 16 developing countries, only one equation yielded significant results. Aid was negatively associated with the size of the governmental surplus (equation 16a). The estimate was significant at the 10 percent level. The aid parameter had a negative sign when related to the tax/GDP ratios (i.e., it reduced tax levels) and also a negative sign in association with the share of the private sector in domestic credit (i.e., it reduced the PS share). In both cases, however, the link was very weak. Thus, the findings seem to reject most of the critics' arguments that aid causes or bolsters domestic policies that impede development. But, by the same token, the findings lend little support to those advocates who maintain that aid invariably yields net benefits to the recipients.

CONCLUSIONS

The empirical findings presented in this paper are preliminary. They need to be confirmed by a larger sample of countries. However, when combined with in-depth country studies and other research findings of a more qualitative nature cited in the text, they do suggest some tentative conclusions.[14/] First, economic growth depends largely upon domestic policies.[15/] Second, financial flows from abroad are most likely to raise output if the policy environment is hospitable and conducive to growth. This assumes, of course, that the projects and activities being financed are well selected in the first place. Third, at least in the market economies covered in this analysis, the private sector tends to be more efficient than the public sector and flourishes best when provided ample access to credit and foreign exchange and when not burdened by heavy taxes. Fourth, countries with governments that do not resort to excessive domestic or foreign commercial borrowing to finance budgetary deficits appear to sustain more rapid growth. Fifth, to be most useful, foreign aid should either reinforce effective policies or promote the reform of defective policies. The evidence suggests that some donors have been somewhat indiscriminate in their distribution of aid in this respect. Stronger linkages between aid flows and policy improvement may be desirable in the future, not only to contribute more effectively to development but also to overcome the "aid-fatigue" that seems to be increasing among taxpayers in some donor countries.

NOTES

1. See P.T. Bauer, Equality, the Third World and Economic Delusion (Cambridge, Mass: Harvard University Press, 1981) and Melvyn B. Krauss: Development Without Aid: Growth, Poverty and Government (New York: McGraw-Hill, 1983). Some aspects of this criticism are discussed in Keith Marsden and Alan Roe, "The Political Economy of Foreign Aid: A World Bank Perspective," Labour and Society, Vol. 8, No. 1 (January-March 1983).

2. See Keith Marsden, "Taxes and Growth," Finance and Development, (Washington, D.C.: International Monetary Fund, The World Bank, September 1983) and Keith Marsden, "Links Between Taxes and Economic Growth: Some Empirical Evidence," World Bank Staff Working Paper No. 605, (Washington, D.C.: World Bank, August 1983).

3. See Daniel Landau, "Government Expenditure and Economic Growth: A Cross-Country Study," Southern Economic Journal, (January 1983).

4. See Keith Marsden, "Links Between Taxes and Economic Growth: Some Empirical Evidence," World Bank Staff Working paper No. 605 (Washington, D.C.: World Bank, 1982) and Marsden, "Towards a Synthesis of Economic Growth and Social Justice," International Labour Review, Vol. 100, No. 5 (November 1969) and "Global Development Strategies and the Poor: Alternative Scenarios," International Labour Review, Vol. 117, No. 6 (November-December 1978).

5. See "Government Policy and Private Investment in Developing Countries" (Washington, D.C.: International Monetary Fund, February 1984).

6. See, for example, Armeane M. Choksi, "State Intervention in the Industrialization of Developing Countries: Selected Issues," World Bank Staff Working Paper No. 314 (Washington, D.C.: World Bank, January 1979); R. Joseph Monsen and Kenneth D. Walters, Nationalized Companies (New York: McGraw-Hill, 1983), and Leroy P. Jones (ed.), Public Enterprise in Less Developed Countries (Cambridge: Cambridge University Press, 1982).

7. See World Development Report, 1983, Ch. 6, and Ramgopal Agarwala, "Price Distortions and Growth in Developing Countries," World Bank Staff Working Paper No. 575 (Washington, D.C.: World Bank, July 1983).

8. Ibid.

9. See, for example, Anne O. Krueger, "Trade Policy as an Input to Development," American Economic Review, Vol. 70, No. 2, May 1980, 288-292; Bela Balassa, "Exports and Economic Growth: Further Evidence," Journal of Development Economics, Vol. 5., No. 2, June 1978, 181-189; Constantine Michalopoulos and Keith Jay, Growth of Exports and Income in the Developing World: A Neoclassical View, AID. Discussion Paper No. 28 (Washington, D.C.: November 1973); Gershon Feder "On Exports and Economic Growth," World Bank Staff Working Papers No. 508 (Washington, D.C.: World Bank, February 1982); and Keith Marsden, Trade and Employment Policies for Industrial Development, (Washington, D.C.: World Bank, 1982).

10. See Donald Kesing, "Trade Policy for Developing Countries," World Bank Staff Working Paper No. 353 (Washington, D.C.: World Bank, August 1979).

11. See R.P. Short, "The Role of Public Enterprises: An International Statistical Comparison" (Washington, D.C.: International Monetary Fund, May 17, 1983).

12. See Keith Marsden, "Creating the Right Environment for Small Firms," Finance and Development, December 1981.

13. See Ibid; Daniel Landau, "Government Expenditure and Economic Growth: A Cross-Country Study," Southern Economic Journal, January 1983; and William G. Tyler, "Growth and Export Expansion in Developing Countries: Some Empirical Evidence," Journal of Development Economics, Vol. 9 (August 1981), 121-30.

14. See World Bank Economic Memoranda: Chile: An Economy in Transition, January 1980; Mauritius: Recent Developments and Prospects, January 1983; Paraguay: Economic Memorandum, June 1979; Peru: Major Development Policy Issues and Recommendations, June 1981; Thailand, Towards a Development Strategy of Full Participation, March 1980; Uruguay: Economic Memorandum, January 1979; and Zaire: Situation Economique et Contraintes, Mai 1980.

15. See Anne O. Krueger and Vernon Ruttan, The Development Impact of Economic Assistance to LDC's (Washington, D.C.: Agency for International Development, 1983).

TABLE 1.1

BASIC ECONOMIC INDICATORS FOR SELECTED COUNTRIES 1970-1979
(average annual rates or ratios in percent)

	GDI GRO	LAB GRO	EXP GRO	GDP GRO	TAX GDP	AID GNP	PS DC	FPI GNP	DS GNP	GS GDP	GNPPC	IND GDP
Malawi	2.3	2.2	4.6	6.3	11.8	8.8	65.2	1.7	2.0	-6.2	200	20
Zaire	-5.0	2.1	-1.1	-0.7	21.5	5.5	32.3	2.7	4.3	-10.4	260	24
Cameroon	7.9	1.3	0.5	5.4	15.1	5.0	109.5[a]	0.6	1.7	-0.2	560	16
Liberia	5.2	2.6	2.3	1.8	21.2	4.4	80.1	5.8	4.2	-2.1	500	26
Thailand	7.7	2.7	12.0	7.7	11.7	0.9	68.4	0.6	0.6	-2.0	590	28
Zambia	-5.6	2.4	-0.7	1.5	22.7	3.7	51.1	-0.9	7.0	-9.9	500	41
Paraguay	18.7	3.1	8.4	8.3	10.3	2.1	78.1	0.8	1.5	0.0	1070	24
Peru	2.7	3.0	1.7	3.1	14.4	0.8	41.3	0.5	4.3	-4.0	730	43
Mauritius	16.1	2.6	16.7	8.2	18.6	4.1	69.8	0.6	1.1	-5.8	1030	28
Jamaica	-9.6	2.2	-6.8	-0.9	23.8	1.8	60.0	3.5	3.8	-9.3	1260	40
Korea	14.9	2.8	25.7	10.3	14.2	1.9	90.6	0.4	3.8	-1.6	1480	39
Chile	-2.0	1.9	10.7	1.9	22.4	0.4	33.9	-0.5	4.6	-3.0	1690	37
Brazil	10.1	2.2	7.0	8.7	17.1	0.2	90.7	1.2	1.5	0.0	1780	38
Uruguay	7.5	0.1	4.3	2.5	20.0	0.4	73.4	0.7	4.7	-2.3	2100	37
Singapore	6.0	2.7	11.0	8.4	16.2	0.6	232.9[a]	7.9	1.1	1.3	3830	36
New Zealand	0.0	2.1	3.4	2.4	27.5	-0.3	77.0	0.0	0.0	-4.3	5930	31
Spain	2.5	1.1	10.8	4.4	19.1	0.0	83.3	0.4	0.7	-1.6	4380	31
U.K.	0.8	0.3	8.2	2.1	30.4	-0.4	51.4	-0.7	0.0	-3.7	6320	36
Japan	3.2	1.3	9.1	5.2	10.6	-0.2	87.9	-0.2	0.0	-3.0	8810	42
Sweden	-1.1	0.3	2.6	2.0	30.9	-0.7	65.7	-0.1	0.0	-2.6	11930	32
U.S.A.	1.9	1.8	6.9	3.1	18.5	-0.3	67.9	-0.3	0.0	-2.1	10630	34

Notes:

GDI = Gross Domestic Investment
LAB = Labor Force
EXP = Exports
GDP = Gross Domestic Product
TAX = Central Government Tax revenue
AID = Net Official Development Assistance (ODA)
PS/DC = Share of Private Sector in Domestic Credit
GNP = Gross National Product
FPI = Direct Foreign Private Investment (net)
DS = Debt Service i.e., repayment of principal

TABLE 1.1 (Cont'd)

BASIC ECONOMIC INDICATORS FOR SELECTED COUNTRIES 1970-1979
(average annual rates or ratios in percent)

GS	=	Central Government Budget Surplus or Deficit (-)			and interest on public or publically guaranteed foreign debt.
GNPPC	=	GNP Per Capita in US$ (1979)	GRO	=	Growth rate
IND	=	Industry			

a/ Figures in excess of 100% indicate that government was a net lender.

Sources: World Development Report, 1981.
World Tables 1980; OECD Development Cooperation Review, several issues.
IMF International Financial Statistics Yearbook, 1982.
IMF Government Financial Statistics Yearbook, 1981.

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TABLE 1.2

INTERCOUNTRY REGRESSION ANALYSIS OF SELECTED VARIABLES

Regression Equation	Number of Observations	Dependent Variable	Constant	AID	TAX	PS	GDI	LAB	EXP	GS	DFI	DS	GNPPC	IND	R2
				Independent Variables											
(1)	21	GDP-GRO	4.292 (4.697)	0.040 (0.136)											.001
(1b)	10	GDP-GRO	4.077 (1.805)	-0.001 (-0.003)											.000
(2)	21	GDP-GRO	11.192 (6.092)		-0.360 (-3.890)										.443
(2a)	16	GDP-GRO	15.831 (6.011)		0.630 (-4.303)										.569
(2b)	10	GDP-GRO	13.914 (5.368)		-0.575 (-3.944)										.660
(3)	21	GDP-GRO	1.187 (0.874)			0.041 (2.637)									.268
(3a)	16	GDP-GRO	1.724 (1.064)			0.039 (2.189)									.255
(3b)	10	GDP-GRO	-1.356 (-0.393)			0.083 (1.648)									.253
(4)	21	GDP-GRO	8.715 (3.444)	-0.140 (-0.639)	-0.328 -3.499)	0.028 (2.073)									.579
(5)	21	GDP-GRO	3.331 (1.509)		-0.112 (-1.483)	0.020 (2.257)	0.289 (4.979)	0.251 (0.576)							.832

Regression Equation	Number of Observations	Dependent Variable	Constant	Independent Variables											
				AID	TAX	PS	GDI	LAB	EXP	GS	DFI	DS	GNPPC	IND	R2
(5a)	16	GDP-GRO	5.209 (1.522)		-0.240 (-1.717)	0.020 (2.032)	0.249 (3.408)	0.583 (0.793)							.845
(6)	21	GDI-GRO	16.717 (3.751)		-0.671 (-2.985)										.319
(6a)	16	GDI-GRO	26.547 (3.984)		-1.233 (-3.329)										.442
(7)	21	GDI-GRO	-0.403 (-0.122)			0.057 (1.510)									.107
(8)	21	GDP-GRO	4.664 (2.466)	0.083 (0.544)	-0.205 (-3.035)	0.022 (2.488)			0.264 (4.722)						.824
(8a)	16	GDP-GRO	8.614 (3.735)	0.025 (0.158)	-0.399 (-4.059)	0.020 (2.337)			0.233 (4.281)						.885
(8b)	10	GDP-GRO	5.344 (2.892)	0.022 (0.177)	-0.293 (-4.063)	0.038 (2.646)			0.304 (5.926)						.966
(9)	21	EXP-GRO	14.071 (2.850)		-0.397 (-1.598)										.118
(10)	21	GDP-GRO	6.497 (7.597)							0.615 (3.375)					.375
(10a)	16	GDP-GRO	7.083 (7.217)							0.637 (3.292)					.436
(10b)	10	GDP-GRO	7.063 (4.747)							0.600 (2.519)					.442
(11a)	16	GDP-GRO	4.919 (4.321)								-0.070 (-0.171)				.002
(12a)	16	GDP-GRO	8.567 (6.524)									-1.281 (-3.365)			.447

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Regression Equation	Number of Observations	Dependent Variable	Constant	Independent Variables											R2
				AID	TAX	PS	GDI	LAB	EXP	GS	DFI	DS	GNPPC	IND	
(12b)	10	GDP-GRO	8.460									-1.439			.638
			(6.159)									(-3.756)			
(13)	21	GDP-GRO	9.619		-0.274	0.015				0.343					.643
			(4.309)		(-3.299)	(1.035)				(1.878)					
(14)	21	GDP-GRO	9.549		-0.252	0.147				0.377			-0.000		.648
			(4.169)		(-2.578)	(1.005)				(1.883)			(-0.472)		
(15)	21	GDP-GRO	9.753		-0.273	0.015				0.343				-0.005	.643
			(3.331)		(-3.150)	(1.007)				(1.817)				(-0.074)	
(16)	16	GS	-1.844	-0.682											.209
			(-1.485)	(-1.922)											

Source: Table 1-1.
The t-values are given in parentheses below the regression coefficients.

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-16-

2.

GOVERNMENT AND ECONOMIC GROWTH IN THE LESS DEVELOPED COUNTRIES

By Daniel Landau

GOVERNMENT AND ECONOMIC GROWTH IN THE LESS DEVELOPED COUNTRIES

INTRODUCTION

For close to 150 years, spending by Washington showed no tendency to rise as a fraction of national income except when it was performing what was regarded as its major function--defending the nation. Its share stayed about 3 percent while the population of the United states swelled from 5 million persons hugging a narrow strip along the Atlantic coast to 125 million spread across a vast continent, while the United States changed from an overwhelmingly agricultural to a predominantly industrial country and became the driving force of the industrial revolution that transformed the world in the nineteenth and twentieth centuries, while the United States moved from a minor country of only peripheral interest to the Great Powers, to the Greatest Power of them all. This remarkable fact should destroy once and for all the contention that economic growth and development require big government and especially centralized government. It is a fact that should be taken to heart by the international planners....16/

Adam Smith founded modern economics with a forceful demonstration that free markets are the best route to prosperity and economic growth. This theme has been developed by economists ever since, including, in our own time, Nobel Prize winners Milton Friedman, Fredrick Hayek, and T.W. Schultz.

In the 1950s, the vast majority of economists studying the poor, less developed countries saw an expanded government role as the route to faster economic growth. More important, the majority of the governments of these less developed countries followed policies of extensive government regulation of the private sector and large-scale government spending. Both the development economists and the less developed countries' (LDC) governments were assuming that the LDCs live in a world where Adam Smith's principles don't apply.

History has vindicated Adam Smith. The LDCs where the government role was more limited, such as South Korea, Taiwan, Hong Kong, and Singapore, have grown much more rapidly than countries where the government role was more extensive, such as India, Nigeria, and Argentina. This is true even though the countries in the successful group lack natural resources and many of the countries in the unsuccessful group have vast natural resources.

During the 1960s and 1970s the argument for government intervention in the economy shifted direction. The new theme was that growth is less important than redistributing income from the rich to the poor; therefore, an extensive government economic role is justified even at the expense of growth. This argument is fundamentally flawed, however. If per capita product stays at $500, no amount of redistribution will bring the poor to a decent standard of living. If, on the other hand, the economy grows from $500 to $2,000 per capita product, the poor will gain immensely even without redistribution. Such a multiplication by a factor of 4 took place in just 22 years in the Far East.17/

A few development economists, including P.T. Bauer and T.W. Schultz, were never fooled and consistently applied Smith's free market economics to the study of the LDCs. Over the years many others have learned from experience. Many recent studies are critical of the government role in LDC economies; this is especially noticeable with regard to regulating foreign trade.18/

The LDC governments have only partially learned the lesson, however, and their movements toward freer markets and lower spending are very slow at best. Economists need to make a clear and forthright statement that the LDCs are not in a different economic universe from the United States. The same policies of less government spending and regulation that are helping this country will also help the LDCs. More important, there is a need for hard and convincing evidence that government spending and regulation have been hurting the growth of these countries.

It is the purpose of this study, commissioned by The President's Task Force on International Private Enterprise, to help provide that evidence through a rigorous statistical study of the impact of government on the growth of the LDCs.

Before going into a description of the study and its findings, it is worthwhile to state briefly why big government will have a negative impact on economic growth. Government regulation of private enterprise will usually slow economic growth for the simple reason that it increases costs. For example, limitations on imports will force firms to use higher cost domestic products or spend resources on evading the import restrictions. Either way, the firms affected by the restrictions have higher costs, lower profits, and tend to grow more slowly. Another form of regulation is found in the practice of setting minimum wage laws. Again, because of these laws, costs rise, profits fall, and growth slows. Finally, consider laws requiring a government license to engage in a business. Firms may spend resources to obtain licenses. If the license laws are strictly enforced they will limit the number of firms operating in a given field. With the number of producers limited, all firms needing their products will have to pay higher prices.

Analyzing all the possible circumstances that could complicate the argument is beyond the scope of this introduction. The central point is clear, however: regulation of the private sector tends to increase costs, reduce profits, and thus reduce incentives to invest and grow.

The basic analysis of government spending is also fairly simple. A private firm operating in a competitive market has incentives and pressures for efficiency and innovation which are lacking (or at least much weaker) for government bureaus and enterprises. The owner of a private company can get rich from the profits of more efficient production, adapting his product better to consumer demand and, especially, inventing new products and production processes. Conversely, if his costs rise, if he doesn't produce what the buyers want, or if others are more quick to invent new products, he can lose sales or even his business and fortune. The bureaucrat or manager of a government enterprise has neither the carrot of a potential fortune nor the stick of bankruptcy to motivate him. Furthermore, the government enterprise is usually a monopoly backed by the government's power to tax. The monopoly means that if one set of managers fails to see the value of an improvement, it is lost. In the private sector, if one firm doesn't want a new idea, another may. Or the inventor himself may start his own business. The private firm cannot tax the general public to pay for its mistakes; the public enterprise frequently can. Last, the public enterprise is under political control and is frequently forced, against the judgment of its managers, to hire less competent employees, to hire too many employees, to produce the wrong product, or to produce in the wrong place. The unregulated private firm is not under such pressures. In sum, if government enterprise is substituted for private enterprise, growth is slowed in three ways: there is lower efficiency, resulting in less output and diminished resources available for growth; more mistakes are made in investment with other people's money; and innovation is reduced.

Unfortunately, the losses go beyond the difference between private and government spending. In order for government to spend, it must raise revenue by taxes; borrowing, or printing money. These revenue-raising devices impose costs on the economy. Taxes reduce net returns to labor and business, which reduces incentives to work, produce, and invest; therefore, taxes reduce both current production and economic growth. Domestic borrowing pushes up interest rates and thus reduces private investment. International borrowing ultimately must be repaid, requiring higher taxes in the future. Finally, printing money to pay the government's bills causes all the economic disruptions of inflation. Among the effects of inflation on economic growth, especially harmful is the uncertainty about future prices and market conditions that it creates. This uncertainty reduces private investment.

Of course, if all LDC government spending were financed by foreign aid the revenue raising problem would not exist. However, as we will see later, the effect of foreign official aid is as much to increase LDC spending as to finance it. In sum, government spending is harmful in two ways: first, government resource use is less efficient than private use and generates less economic growth, and second, the process of transferring resources to the government from the private sector imposes additional costs and losses of output and economic growth.

However, theory will never suffice to convince LDCs of the virtues of a more limited government role in their economies. Only hard evidence that government spending and regulation have been hurting their growth can hope to change things. The purpose of this study is to bring out the hard objective evidence in the actual experience of LDC growth and lack of growth.

For the study, annual data for the years 1960-1980 were gathered for 65 LDCs. The data cover general government expenditure divided into five types; revenue raising divided into four types; interest rates and exchange rates; private investment; education; literacy and health; the structure of production; historical factors; political factors; and geoclimatic factors. It is necessary to allow for all these elements to avoid spurious relations.

The sample was restricted to countries with populations over one million; a smaller country's economic growth is too often dominated by special situations. Availability of data limited the study to 65 countries and the period to 1960-1980. The sources of the data are publications of the International Monetary Fund (IMF), the World Bank, and the United Nations. The IMF data were used as a base and other data were integrated. The effort was enormous, but it produced one of the best data sets in the world for investigating economic growth in the less developed countries.

The rest of the report is organized as follows: Section II describes the approach used in the study; Section III gives further details about the data set assembled; Section IV gives the statistical results; the last section is a nontechnical statement of the findings of the research. Readers who are not economists may want to skip directly to this final section.

Regression Model

There are no generally accepted models of the growth process and therefore no standard analytical frameworks that are appropriate for studies such as this one.[19] The best approach possible is to use a very simple production function framework. The level of real product depends on the stocks of labor, physical capital, and human capital available to the economy and the productivity of their use. Productivity will depend both on technology and the efficiency with which factors of production are used. Per capita product will depend on per capita stocks of human and physical capital, hours of work per capita, and productivity. Increases in per capita product will be a function of the increases in and the levels of the four elements which determine per capita product. Further formalization of this framework, while obviously possible, does not seem to be worthwhile.

The explanatory variables used in the regressions are discussed in detail below; of them, five directly relate to human and physical capital. All other variables in the regressions will exert their influence on growth either through productivity or by changing the rate of accumulation of human and physical capital. It is not always possible to say if a particular category of government spending or any noneconomic regressor is influencing the rate of accumulation or productivity.

Economic growth is measured for purposes of this study by the rate of increase in per capita gross domestic product (GDP).

The explanatory variables used as regressors are listed in alphabetical order in Appendix A. The regressors divide into 10 categories: measures of government expenditure and revenue raising; regulation and other government impacts; the level of per capita product; international economic conditions; human and physical capital variables; the structure of production; historical political factors; resources and geoclimatic factors; population; and a time trend. All the regressors listed in Appendix A are plausible influences on the growth rate and virtually all of them have been suggested as significant by scholars studying economic growth. There were two additional motivations for looking at such a wide range of potential influences on growth: (1) to avoid spurious correlations between the key government expenditure variables and economic growth and (2) because many of them are of interest in themselves (the rate of population growth, changes in the terms of trade, the country having been a colony, etc.). A proper study of the impact of government expenditure required the assembly of a uniquely large data set, which could shed new light on many controversies in the study of economic development. It would not make sense to miss the opportunity.

The government expenditure used in this study is general government expenditure, including national, state, and local governments. It is divided into five types: consumption other than defense or education, (OCSA); education (AEDS); defense (ADS); transfers (ATRNS) and capital expenditure (AKES). the revenue sources are current revenue (AREVS); the deficit (BREVS); and a partial measure of foreign aid, official transfers from abroad (AOFTS). To run a pooled cross-section, the expenditure figures must be comparable over time and across countries; the most direct way to achieve this is to express them all as shares in GDP. These eight regressors were also made averages of three lagged values to prevent contemporaneous correlation between these regressors and the disturbance.

The regulation and other government impact variables are: the rate of change of the money supply (DMSS); the inflation rate (AINF); an index of the real exchange rate (AEXRR); and the real interest rate (ARIR). The last three regressors are also averages of three lagged values to avoid contemporaneous correlation with the disturbance. The level of per capita product (LRGDP) was included because the author's cross-section study showed that countries with lower per capita product grow faster, a sort of "catch-up effect."[20/]

The international economic conditions regressors are: the change in the country's terms of trade (DTRT); the growth rate of world GDP (GDPWGR); and the world inflation rate (PIWGR).

The variables for human and physical capital are: private investment as a share of GDP (AIP); a direct measure of current education output (EDO), and life expectancy at birth in 1970 (LE7), along with the government investment in human and physical capital (AEDS and AKES). All of these are investment measures except LE7, which is a sort of stock measure. AIP is also the average of three lagged values. The EDO is a relative income weighted total of enrollment rates at all three levels of education.[21/] A direct measure of education output is useful since government education expenditure may not be a good proxy for the level of investment in this kind of human capital.

The "structure of production" variables are: the shares of agriculture, manufacturing, and other industry in GDP. They are A, M, and O, respectively, in Appendix A. The "structuralist school" has held that the structure of the economy in terms of agriculture and industry shares influences the growth rate independent of the level of per capita income so that deliberately changing the structure could change the growth rate.[22/] The author's previous study found no structural effects, but this study allows for a more rigorous test.

The historical political factors examined were: a dummy variable for the country having been a colony (COL); a dummy for the country that has been a democracy since independence or the 1950s (DEMO); the years the country has been independent

(YI); two measures of internal political stability (the political death rate (PDR) and the incidence of coups and attempted coups (COUP); a dummy for wars with foreign countries (WFS); and the share of the population which is of European extraction (SEUR). The last variable comes from a study by the author of the spread of modern economic growth and higher per capita incomes from Western Europe to other parts of the world.23/ This study showed a high correlation between the European share and the level of per capita income attained. The explanation given there was that Europeans brought with them the market style, property rights, and the public goods, which together helped European economic growth. Here, SEUR is testing whether these effects still influence current growth.

The resources and geoclimatic factors are: agricultural land per capita (AGLPC); the distance to the nearest seaport for landlocked countries (DLP); a dummy for major oil producers (OIL) (the other industry share in GDP [O] also picks up general effects of having mineral deposits); rainfall (RAIN); and temperature (not in Appendix A since it was insignificant).

The two population regressors are: the population in millions (LPOP) and the growth rate of population (PGR). The latter variable tests for neo-Malthusian and related concerns; the total population is a measure of the scale of the economy, because per capita income is a regressor. There is also a linear time trend (T).

Data and Sources

The data set includes 65 countries and covers the years 1960-1980. The sample was limited to countries with populations of one million or more, because in smaller countries special circumstances can too easily dominate general patterns. Missing data reduced the countries included to 65 and restricted the period covered to 1960-1980.

The countries in the data set are Cameroon, Chad, Egypt, Ethiopia, Ghana, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Morocco, Nigeria, Rhodesia, Rwanda, Senegal, Sierra Leone, Somalia, South Africa, Sudan, Tanzania, Togo, Tunisia, Uganda, Upper Volta, Zaire, Zambia, Bangladesh, Burma, India, Iran, Israel, Jordan, South Korea, Malaysia, Pakistan, Singapore, Sri Lanka, Syria, Thailand, Greece, Portugal, Spain, Turkey, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Trinidad, Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela, Indonesia, and Papua.

The basic data sources were the International Monetary Fund publications, International Financial Statistics, and The Government Finance Yearbook. Data not available from these sources were taken primarily from the World Bank World Tables and a variety of U.N. publications, especially the Yearbook of National Account Statistics. Because the coverage of Government Finance Statistics starts at the earliest in 1970, the non-IMF sources were used for government expenditure and revenue from 1960 to 1970. In order to make a more consistent series and because the IMF data are generally of higher quality, whenever IMF data existed the data from other sources were treated as a measure of the change in the IMF figure.

The following data were taken from the International Financial Statistics with occasional use of the World Tables: the exchange rate, the money supply, the discount rate, official and private unrequited transfers, government consumption expenditure, gross fixed capital formation, increase in stocks, GDP, the GDP deflator, and population. These data were annual for each country. The same source also provided the world GDP measure and the world inflation measure.

The following data were taken from the Government Finance Statistics Yearbook, 1983: total revenue (central government and other levels of government); total expenditure plus lending minus repayment (all levels of government); current expenditure (all levels); capital expenditure (all levels); defense expenditure (central government); educational expenditure (all levels). Government expenditure data not available from this source came from the World Tables and a variety of U.N. publications. Missing defense expenditure data were filled in from the SIPRI Yearbook.

A major decision had to be made for countries that only reported central government expenditure on a systematic basis. If all these had been excluded, the sample would have been reduced to less than 50 countries. Such a step would not really have been justified, since for many of them the central government spends 90 percent and more of all government expenditure. For countries where the central government spends over 90 percent of total expenditure, estimating general government expenditure shares in GDP from central government shares will be accurate enough except for educational expenditure. Educational expenditure data for these countries were taken from the UNESCO Yearbook. Countries where the central government does not spend 90 percent of general government expenditure and which did not report expenditure of other levels of government were excluded from the sample.

The other variables came from a variety of sources. Data on wars came from the Political Handbook of the World. The European share in the population and rainfall data came from the World Factbook. Agricultural land data are from the FAO Production Yearbook. Life expectancy, enrollments, and the shares of agriculture, manufacturing, and other industry in GDP came fromm the World Tables and the World Development Report. The data on coups and political deaths came from the World Handbook of Political and Social Indicators.

Regression Results

The regressions are all ordinary least squares (OLS). Most of the regressors are lagged values, which avoid problems of contemporaneous correlations between regressors and the disturbance. All the regressions include as explanatory variables private investment, the level of per capita product, government expenditure shares in GDP, a human capital measure, population, the population growth rate, and a time trend. Other regressors are included in the reported regressions if they are significant or of special interest. All the regressions had heteroscedasticity, which was tested for by Bartlett's test and corrected.

Most of the regression tables have four regressions, one for each of four subsamples of the data. Two of these subsamples are for annual observations of the growth rate, one is for four-year periods, and one for seven-year periods. For longer periods there were too few observations to test the hypotheses properly. The first regression in each table is usually what is called the "small annual" subsample. It has 489 usable observations. While the whole data set is 1,190 observations, many of them lack data on foreign aid or the discount rate. The small annual subsample is limited to the higher-quality data, which include both of these variables. The "large annual" subsample includes observations which have data on foreign aid, 825 usable observations. The large annual subsample contains poorer quality data and this probably explains why the R^2 only reaches .472, whereas it reaches .629 for the small annual subsample. For the four-year regressions, the dependent variable is the compound annual growth rate over four-year periods. The explanatory variables are mostly averages over three years, ending with the first year of the growth period. As a result, there are only 151 usable four-year observations. The seven-year regressions use the compound annual growth rate over seven-year periods and there are 98 usable seven-year observations.

For the longer periods, the R^2 is .71. There are two obvious explanations for the higher R^2: 1) the growth process is more regular and thus more easily explained for the longer periods; and 2) the random error in the source data washes out over the longer periods. It is difficult to choose between the various subsamples for reliability. The annual subsamples have more degrees of freedom, but the multi-year subsamples look at longer periods.

The basic regressions are in Table 2.1. Table 2.2 brings together the major results for government expenditure regressors and foreign aid. Table 2.3 summarizes results for other variables of special interest. Table 2.1 and Tables 2.4-2.7 contain actual regressions behind the key Table 2.2. (Many of the coefficients in Table 2.3 are insignificant, so the actual regressions are not included in the paper.) The regressions were also tried with income interaction terms--the regressor times per capita real GDP, LRGDP. The interaction terms were only statistically significant for the annual subsamples. The coefficients in Table 2.2 are compared with the results with interaction regressors in Table 2.8. Tables 2.9 and 2.10 have the most important regressions including interaction terms.

The most important results are summarized in Table 2.2. Panel A brings together the coefficients for OCSA--the share in GDP of general government consumption expenditure other than education and defense. The third line in Panel A allows for the effects of this type of expenditure on taxes, deficits, and private investment. The coefficients are all negative and highly significant; this result suggests that this type of expenditure has a marked negative impact on economic growth. The growth rates and the shares in GDP are both in percentages; so, taken literally, the coefficient of -.234 for the small annual subsample says that an increase by 1 percent of GDP in this category of government expenditure would slow growth of per capita product by 0.25 percent. For this subsample, the growth rate of per capita GDP averages 2.95 percent and OCSA has a mean of 6.6 percent of GDP. The impact of this kind of spending on growth could be important.

Some readers may be bothered by the inference of causality from a regression coefficient. Such caution is usually in order, but it is argued at the end of this section that, for the results in this paper, we can safely infer that causality runs from government spending to changes in the growth rate.

The other lines in Panel A show us how the coefficient of OCSA changes when first the private investment share (AIP) is held constant in line 2 and when second private investment, the share of taxes in GDP (AREVS) and the share of deficits in GDP (BREVS) are all held constant in line 1. When we go from line 3 to line 2, the coefficients of OCSA change very little, indicating this kind of spending does not crowd out private investment directly. When we go from line 2 to line 1 the coefficients from three of the four subsamples decrease in absolute value. Since the coefficients for AREVS and BREVS are negative for these subsamples (see Table 2.4) we can infer that part, but not all, of the negative impact of OCSA is due to the need to raise revenue to finance this type of spending.

Panel B compares the impact of government educational expenditure as a share in GDP (AEDS) with a direct measure of education output by weighted enrollment rates (EDO). The coefficients for AEDS alone, when no other human capital regressors are in the regression, are in line 3; they are all positive but far from statistically significant. The coefficients for EDO when AEDS is not in the regression are in line 4; they are all positive and highly significant. The contrast between lines 3 and 4 implies that education contributes to economic growth, but government spending on education in the LDCs is not efficient at producing actual education. In the basic regressions for the annual subsamples, the human capital regressor was life expectancy (LE7). EDO was also significant when included with AEDS in these basic regressions, but not as significant as LE7. For the longer periods, the relation was reversed, with EDO slightly more significant.

Panel C presents the same comparisons as Panel A did for the share of military expenditure in GDP (ADS). The third line again indicates the 'net' impact, allowing for the influence of this kind of spending on private investment, taxes, and deficits. The impact is roughly zero, except for the seven-year subsample, where it is significantly negative. A comparison of lines 1 and 2 indicates the coefficients increase when AREVS and BREVS are held constant so part of the impact of military spending is through the financing. However, even when tax and deficit shares in GDP are held constant, the impact of military spending is not statistically significant. Assuming that the first three subsamples present an accurate picture, the impact of ADS is markedly different from the strong and significant negative impact of OCSA.

Panel D provides the same anlaysis as Panels A and C for current nonconsumption expenditure (ATRNS). The net impact in line 3 ranges from positive and significant--the small annual subsample--to negative and insignificant--large annual subsample. Between lines 2 and 3, the coefficients all decrease in algebraic value, which indicates some crowding out of private investment. A comparison of lines 1 and 2 gives no consistent picture. The coefficient for ATRNS is statistically significant for the small annual subsample and has a value of .085 in line 3. The mean value for ATRNS for this subsample is 4.6 percent of GDP, so the implied impact of this type of expenditure is limited.

Perhaps the most important regression results are in line 3 of Panel E, which gives the net impact of the government capital expenditure share in GDP (AKES). The coefficients in line 3 are all negative, but only the coefficient for the small annual subsample is statistically significant. Thus, on net, government capital expenditure is at best no help to growth and is perhaps slightly harmful. This surprising result is explained by comparing lines 1,2, and 3. In line 1, holding constant both private investment and revenue raising, the coefficient of AKES is positive in three of the four cases, though the statistical signficance is only in the 10-25 percent range. When we allow for the revenue raised to finance government capital expenditure (line 2) the coefficients fall almost to zero, and when we allow for crowding out of private investment (line 3) the three coefficients that were positive become negative. In sum, there is some return to government investment, but the return does not cover the opportunity cost in terms of higher taxes, larger deficits, and the crowding out of private investment. For the small annual subsamples, the mean value of AKES is 7.1 percent of GDP so that a sizeable fraction of the LDCs' GDP is going for government investment with no return in faster growth.

In contrast to government investment, private investment (AIP) does increase the growth rate. AIP is the first regressor in Table 2.1; the coefficients are all positive and the significance levels run from better than 1 percent to 17 percent. While the payoff to private investment is much better than public investment, it is not what one would hope for. The last section of the report gives some possible reasons for this result.

Panels F and G summarize the regression results for official unrequited transfers (AOFTS)--our proxy for foreign aid--and private unrequited transfers (APUTS). The "net impact," allowing for effects on government expenditure and private investment, is as usual in line 3. For official transfers, only one coefficient is positive and statistically significant, while one is negative and significant at the 10 percent level and two are insignificant. For private transfers, two of the coefficients are positive and highly significant, one is positive and significant at the 20 percent level, and one is insignificant. In short, private transfers help, but official transfers may be doing nothing to further economic growth.

This result will be surprising to many people, but it is easily explained by comparing lines 1, 2, and 3 of Panel F. In line 1 the regressions include taxes, deficits, government spending, and private investment. Holding all those constant, official transfers have a positive and statistically significant impact in three of the four subsamples. In line 2 the regressions don't include taxes and deficits; the coefficients for AOFTS are reduced in size and significance, indicating a positive association between government revenue-raising and foreign aid. In line 3 taxes, deficits, government expenditure, and private investment are all dropped from the regressions. This again reduces the coefficients for AOFTS. Thus the problem with official foreign transfers is that they reduce private investment, increase government expenditure, and even increase taxes and deficits; that is, such aid causes government expenditure to increase by more than the external financing it provides. AOFTS does not include all foreign aid, and it is possible that broader, but unavailable, measures of official aid would show different results. However, there is no reason to believe AOFTS is a bad proxy.

In Table 2.1 the second regressor in each of the four regressions is LRGDP, the lagged level of per capita income. The coefficient is always negative and highly significant. Thus the "catch-up effect," so visible for the developed countries, also exists for LDCs. The simple correlation between per capita product and growth rates is positive. For example, the World Bank's "low income economies" (excluding China and India) grew at 0.8 percent per annum 1960-1981; "lower middle income economies" grew at 3.4 percent per annum; and "upper middle income economies," at 4.2 percent per annum. Evidently, the simple correlation is misleading.

Panel A of Table 2.3 summarizes the coefficients for A, M, and O--the shares of agriculture, manufacturing, and other industry in GDP. For three of the four subsamples, they were not statistically significant and therefore not included in the basic regressions in Table 2.1. The exception is the large annual subsample. The other industry share (O) includes minerals and was close to significant for two more of the subsamples. The dummy for a major oil producer (OIL) had a positive and statistically significant coefficient in three of the four cases (see Panel B). These results suggest that minerals are an aid to growth; the results for M cast doubt on the "structuralist" notion that changing the structure of the economy will promote faster growth. Perhaps the benefits of industry are a result, not a cause, of healthy growth. In other words, the industry share increases naturally with per capita GDP--included in the regressions--but promoting it to artificial levels does not accelerate growth in most cases.

Panel C contains the coefficients for agricultural land per capita (AGLPC). The coefficients are both positive and negative, with none statistically significant. Thus, there is no evidence that a shortage of agricultural land was hurting growth over the 1960-1980 period.

Panel D of Table 2.3 brings together the coefficients for the rate of increase of population (PGR). The signs are negative, with one coefficient statistically significant, two close to significant, and one not significant. The coefficients range from -.18 to -.398. Taking the middle of this range, a coefficient of -.3 would imply a 1 percent decrease in the population growth rate, which would increase growth by .3 percent. There is room for various interpretations of the PGR results. The author's interpretation is that slower population increase would help economic growth, but not by much.

Panel E has the coefficients for population (LPOP). Because the regressions contain a variable for per capita income, LPOP tests for possible advantages of large (or small) size for economic growth. (Population is measured in millions.) The coefficients for the multiyear periods are negative and statistically significant, suggesting that larger countries are at a disadvantage. The coefficients for the annual regressions are all insignificant. In Tables 2.9 and 2.10--regressions with income interaction terms--the coefficients for LPOP are negative, but the interaction terms are positive. This would imply that smaller countries have advantages, but only at low income levels.

Panels F, G, and H of Table 2.3 look at the impact of world economic conditions on LDC growth. Panel F looks at the impact of world growth rates (GDPWGR); they seem to be quite important in the annual regressions with positive, highly significant, and numerically large coefficients. For the longer periods, GDPWGR is either insignificant or even has the wrong sign. The impact of changes in the country's terms of trade is examined in Panel G. In three of the four cases DTRT is not statistically significant and in one it has the wrong sign. When DTRT and DTRTX--the change in terms of trade times the level of per capita income--are added to the small annual subsample interactions regressions in Table 2.9, the coefficient of DTRT is .037, with a t-value of 1.46, and the coefficient of DTRTX is -.018, with a t-value of 3.00. This indicates some impact of change in the terms of trade at very low income levels. DTRT and DTRTX were statistically insignificant in the interactions regressions for the large annual subsample. Thus there is some evidence of impact of changes in the terms of trade on short-run LDC growth, but no evidence of long-term influence. Panel H looks at the impact of world inflation rates (PIWGR); the coefficients are not statistically significant. To sum up these three sets of results, world economic conditions can have a significant impact on LDC growth in the short run, but over longer periods there is no evidence of impact of world prosperity, LDC terms of trade, or world inflation.

In Panel I we have the results from adding COL--a dummmy variable for the country having been a colony--to the basic regressions in Table 2.1. The coefficients are all negative, but none are even close to statistically significant. Thus, by this test, colonialism is not now slowing the growth of the former colonies. When the former colonies were divided up into four classes--former U.S. and Japanese colonies, former British colonies, former French colonies, and former colonies of other countries--the coefficients were generally positive, but statistically insignificant. (These regressions are not included in the report.) It is accordingly difficult to empirically establish any lingering effects of colonialism on the growth of the LDCS. Of course, the use of dummy variables may not be the right test, but the author knows of no better one. The effects of colonialism on the level of per capita income in former colonies is not relevant for this study. In a forthcoming study with a differet body of data, however, the author found no negative relation between having been a colony and the level of per capita income.

Panel J looks at the coefficients if YI--years the country was independent--is included in the regressions. Many students of development from various disciplines have suggested that the recently independent ex-colonies are undergoing a process of "nation building" which, until completed, can harm economic growth.

Panels K and L look at certain internal political factors. Panel K gathers together the coefficients for the dummy variable (DEMO). Three of the coefficients are negative; two of the three are also statistically significant and large in absolute value. The fourth coefficient is positive but statistically insignificant. These results support a painful idea that has circulated in development circles for many years, that democracy is an expensive luxury for poor countries. Panel L includes the coefficients for COUP--total successful and attempted coups divided by the years since the coup to the current year. This variable is one of two tried as measures of internal political instability. Three of the four coefficients are negative; for the annual subsamples the coefficients are also statistically significant. Clearly, political stability aids growth.

The set of variables classified as "regulation and other government impacts" is of course incomplete since most government regulatory activities have not been investigated to the point where we have internationally comparable quantitative measures. (The World Bank has done some work on price distortions, but the published results are not usable in a study such as this one.) The variables we do have showed some importance, especially in the two annual subsamples. The change in the money supply was close to significant and had a negative coefficient. The lagged average inflation rate was statistically significant, with a negative coefficient for the large annual and the four-year periods subsamples. These results provide some support for ideas that inflation and rapid monetary growth impose costs on the economy. AEXRR is a three-year lagged average of an index of the real exchange rate--base 1960=100; it had positive coefficients for the annual subsamples. The coefficients were significant at the 16 and 4 percent levels in the small and large annual subsamples, respectively. AEXRR is obviously an imperfect measure of exchange rate distortions, so it is not surprising that it was not significant for the other subsamples. An alternative to AEXRR based on blackmarket exchange rates was for some unknown reason insignificant in all regressions. The final variable in this set is the real interest rate (ARIR).

Only the 489 observations in the small annual subsample contain data on the interest rate, so this regressor could not be tested for the other subsamples. In the small annual subsample regressions ARIR has a positive and highly significant coefficient. This result implies that efforts to hold down interest rates in spite of inflation have hurt economic growth.

The regressions were also run with income interaction terms of the regressor times per capita income. The main interaction results are in Tables 2.9 and 2.10. The interaction regressors are indicated by the basic regressor symbol, with an "X" added at the end. The interaction terms were statistically significant only for the annual subsamples and there, of course, for only some of the regressors. The major results for these subsamples from Table 2.2 are compared with the interaction results in Table 2.8. The impact of a unit change in a regressor where there is also an interaction regressor will be the coefficient of the basic regressor plus the income level of the country times the interaction regressor's coefficient. In Table 2.8, when the regressors being compared had interaction terms, the comparison was made at the subsample mean per capita income. When the interaction regressor was of very low statistical significance or when the inclusion of the interaction regressor reduced the original regressor to very low significance the interaction term was not used. Accordingly, some of the regressors compared in Table 9 do not have interaction terms.

In Panel A, OCSA does not have an interaction term. The coefficients from the regressions with interaction terms have lower t-values but the coefficients remain significant and the absolute value of the coefficients increases. In Panel B the coefficients for government educational expenditure (AEDS, AEDSX) remain not statistically significant, while three of the four coefficients for the direct measure of education (EDO, EDOX) are significant. The interaction regressors for military spending were themselves not significant, but in the regressions with interaction terms the coefficients for ADS increased in significance and algebraic value. For the large annual subsample the military spending coefficient went from insignificant to positive and significant. In Panel D the transfer expenditure interaction coefficients were not significant, but the significance level for ATRNS fell.

Panel E looks at government capital expenditure. The two regressors AKES and AKESX were both statistically significant in the basic regressions in Tables 2.9 and 2.10. The net impact at the sample mean was zero for the small annual subsample (compared to negative and significant in Table 2.2); for the large annual subsample, the net impact at the mean remained negative. Panels F and G show that the inclusion of interaction terms in the regressions made very little difference in the results for official transfers (AOFTS) or private transfers (APUTS). In general, the inclusion of interaction terms made some difference in the results, but it did not change any of the basic implications.

Before summarizing the findings of the report, it is appropriate to address two methodological issues: the use of international cross-section regressions and the inference of causality from regression coefficients.

Some economists have doubts about the validity of cross-section regression studies of the LDCs. One criticism of studies such as this one is that the countries are too different in history, size, structure, etc., to be comparable. Thus the claim is that South Korea and Somalia or India and Paraguay are just too different to include in the same regression. This view, while intuitively plausible, on closer examination appears to be unfounded and perhaps even unscientific.

Factors like size, per capita income level, and even many historical influences can be allowed for by including them in the regressions as is done here. Some critics of the approach taken here have suggested the set of 65 countries ought to be divided by geography, size, or income level into more homogenous groups and the regressions run inside these groups. Such an approach would create samples too small to test for all the possible influences on growth and would tend to produce samples too homogenous in key variables to allow tests of their impact. In addition, such an approach implicitly raises doubts about the point of economic studies of the LDCs. If they are too different to put in the same regression, how much of what we know about one group is relevant to another? If conclusions are not relevant across groups of countries, of what scientific value are they? Furthermore, if generalization is not possible across countries, who is to say it is possible across time? Why should we believe the experience of India in the 1960s is relevant to current issues, even in India? Perhaps the strongest answer to criticism of international regressions is that the regressions implicitly test if the countries are comparable. If the impact of government consumption expenditure or any other factor is very different in the types of countries in the sample, the standard error of the estimated regression coefficient will be high and the coefficient will be statistically insignificant. Thus, if many of the coefficients are statistically significant, as this study found, then the countries are shown to be sufficiently comparable to include in the same regression.

Finally, rejection of cross-section statistical studies can make us prisoners of conventional wisdom for long periods. If cross-section studies are not used, we need decades of experience to test accepted theories.

Causality is a perennial problem for empirical studies in economics. Ultimately, problems of causality can be solved only by sophisticated theoretical frameworks which don't yet exist in the study of economic growth and development. Without such a framework it usually behooves the researcher to be cautious about suggesting causality. If the regression of Y on X produces a negative coefficient, how do we know that (1) the correlation is not spurious and that Z, a more fundamental influence, is not causing the changes in both X and Y, and (2) the increases in X cause the decreases in Y and not the reverse?

While these problems could exist for the coefficients of regressing per capita income growth on the various government expenditure shares, they most likely do not. Let us look at the issue of third factors and spurious correlations. First, the factors allowed for in these regressions cover most of the range of plausible influences on economic growth. Second, as outlined in the introduction, there are good reasons for believing government expenditure will have an impact on economic growth.

One important category of influences on economic growth is not, however, adequately covered by the regressors used here. That category is regulation. How do we know the coefficients found here do not merely reflect bias from missing government regulation regressors? One can never be certain. That situation is unlikely, however, because of the large differences in the coefficients for the various types of government expenditure. Government regulation has, in general, grown along with all types of government expenditure, so that if the coefficients for expenditure were mere proxies for the missing regulation regressors, the large differences between the coefficients for OCSA and ATRNS ought not to exist. Furthermore, the notion that the expenditure coefficients are proxies for missing regulation data does not square with the changes in coefficients when taxes and deficits or private investment are added to (or dropped from) the regressions. There is obviously, some correlation between expenditure and regulation which would change the coefficients if we had the missing regulation regressors, but there is no reason to believe the results here are spurious because the set of regulation variables is incomplete.

The other causality problem is reverse causality. How can we be fairly certain that government expenditure is influencing economic growth and that economic growth is not influencing the government expenditure shares in GDP? First, simple reverse causality has been eliminated because the government expenditure shares are lagged so they take place before the growth rates regressed on them. Thus the only way that changes in the growth rate could cause the changes in government shares would be if there were long runs of high or low growth rates. That is, if growth were already slow in 1960 and it induced larger government spending in 1961 and 1962, while slow growth continued from there on, we would get the negative coefficient when we regressed growth rates from 1963 to 1980 on lagged government spending shares. However, the growth rates are not highly correlated over time. They frequently change from high to low and back again. Many countries switch from positive to negative growth rates and back again more than once. Thus the long runs necessary to produce reverse causality with lagged regressors don't exist.

From a substantive point of view the results also do not square with a reverse causality. Slower growth could cause higher government spending shares in GDP in one of two ways: (1) the growth of actual government spending could be independent of the growth of national product, so that when the growth of national product slowed the steady growth of government spending would increase its share in GDP or (2) slow growth of GDP could induce the government intentionally to spend more either to reduce suffering or to induce faster growth. Neither of these possible reverse causality scenarios fits the pattern of coefficients for the various government shares. The first hypothesis of exogenous growth in government spending would imply the coefficients for all government spending shares ought to be similar and negative. In fact, the coefficients for the various types of government spending are quite different, with some (AEDS, ATRNS) mainly positive. The second possible route for reverse causality, deliberate increases in government spending when growth slows, would imply that maximum increases in government spending ought to come in transfers (ATRNS) or capital spending (AKES). In fact, the strongest negative coefficients are for OCSA. Finally, no scenario for reverse causality can explain the changes in the expenditure coefficients when taxes, deficits, and private investment are added or removed from the regressions.

In sum, in spite of the usual dangers of inferring causality from regression coefficients, the richness of the empirical results for this study allows that luxury with relative safety.

CONCLUSION

The mass media frequently paint a picture of total gloom and doom about the less developed countries. It is easy to get the impression that all LDCs face starvation or, at the very least, continuously falling standards of living. The United Nations and other international organizations frequently provide the basis for ever deeper pessimism. Their gloom is so pervasive one wonders if it isn't a form of marketing.

The real picture is quite different. In the last two decades, the majority of the LDCs have achieved significant growth and increases in their standards of living. The higher income LDCs have been, on average, growing faster than the developed countries, and they are slowly closing the gap. The real problem is not lack of growth, but rather inadequate growth, especially among the poorer LDCs. This study and previous work by the author have shown that the poorest LDCs have the potential for faster growth than either the better-off LDCs or the developed countries. This conclusion is statistically solid. The gap between rich and poor countries ought to be closing, but it is closing only for a minority of the LDCs. Why is this tremendous potential for growth and human betterment not being realized?

Economic theory and history point to the answer. The mainstream of economics has demonstrated again and again the harmful effects of government spending, taxation, and regulation beyond the basic essentials. Some development economists (including many at the World Bank) have of late been doing very valuable research on the real effects of LDC government policies; they are finding that the policies are often very harmful. The march from 19th-century under-development to relative affluence in today's developed countries has been by the free market route, with limited government intervention in the economy. Recent experience with the welfare state in North America and Europe has again demonstrated the harmful impact of big government and economic growth. Socialism has failed economically from Havana to Poland and Peking. Despite all this, the governments of most LDCs have acted, and the majority continue to act, as if they live in a different economic universe, where government spending and regulation promote economic growth.

The point of this study was to determine the results of LDC government spending and regulation. Have they helped or hurt LDC growth?

The data for a thorough study of regulation and price distortions were generally not available. The study did look at government efforts to keep up the value of their currency in spite of inflation, and the results indicate this has hurt their growth. For countries for which we had data on interest rates, the statistical results show a strong connection between interest rate distortions and economic growth. Efforts to hold down interest rates in spite of inflation hurt economic growth. The data also indicate that rapid inflation and growth of the money supply are harmful to growth. However, the conclusions about inflation and monetary growth are not so solid.

The focus of the study was on the effects of government expenditure on economic growth. This is a very important area that has been virtually neglected. Government expenditure was broken down into five types. General administration expenditure has the strongest statistically negative impact on growth. Military spending does not have a clear-cut impact on growth. In some cases, it was found to slow growth and in others it appeared to help.

The most important finding was that what is called development expenditure has no positive impact on growth. The explanation is threefold: (1) government investments are often inefficient, generating on average a low return; (2) the taxation and borrowing needed to finance government capital expenditure slow growth; and (3) government investment "crowds out" private investment which does contribute to economic growth. The development budget is the main tool for promoting growth in most LDCs, but in fact the huge sums spent are not increasing economic growth. All capital expenditure requires diversion of resources from current use for food, clothing, health care, education, etc. The development expenditure of LDC governments thus reduces the meager current standard of living of their citizens without the compensation of higher standards of living in the future.

Educational expenditure by LDC governments aids economic growth, but the effect is surprisingly weak and not at all statistically clear cut. However, if we measure education directly by enrollments there is a strong impact on growth. The implication is that government educational spending is inefficient and more spending doesn't translate well into more actual education. Transfer expenditures include paying interest on the national debt, social security, and similar "safety net" expenditures. Surprisingly, such expenditures do not slow economic growth; they may even help it.

Unlike government investment, private investment in the LDCs does promote growth, and if such investment were increased, growth would accelerate. However, private investment helps less in the LDCs than in the developed countries. Part of this result is simply due to deficiencies in the data. Many government enterprises which operate autonomously are counted as private even though they are in fact as public as the Post Office in the United States. However, this is not the whole explanation. An additional factor is probably various government policies which, on the one hand, prevent private enterprise from entering the most profitable and productive activities and, on the other hand, make nonproductive investment profitable. If government limits imports enough it will be profitable for an auto company to make automobiles in Chile, but it will not help Chile's economic growth. This sort of thing is extremely widespread in the LDCs, so that a substantial share of genuinely private investment is misdirected due to government distortion of prices and other incentives.

Slow growth of so many LDCs is frequently explained by lack of industry. Very expensive limitations on imports into LDCs are often justified as promoting industrialization, which is supposed to accelerate economic growth. Industry is certainly a part of economic growth, but it does not follow that promoting it artificially will accelerate growth. It may be that industry only helps growth if it appears naturally and thus is efficient. The data seem to confirm this view. Countries with a larger share of industry than is typical for their income level do not necessarily grow faster. Thus, all the regulation and expenditure being used to promote industry may not be helping growth. The data are ambiguous on this point, however, and it is not as well established as some of the other findings.

Conventional wisdom holds that the LDCs need more aid from the developed countries, and that if they get it, they will grow significantly faster. The data refute this conventional error. The statistical tests were run on four subsamples of the total data set. For two of the subsamples foreign aid did no good, for one it actually did harm, and for only one of four was it a net benefit. Even for this one, massive amounts of aid would be necessary to increase economic growth by even 0.5 percent per year. The reason for the ineffectiveness of foreign official aid is clear from the data: foreign aid promotes additional government expenditure and reduces private investment.

These results may be surprising to many, but they would not surprise P.T. Bauer, who wrote:

> Since official wealth transfers go to governments and not to the people at large, they promote the disastrous politicization of life in the Third World. The tendency towards politicization operates even in the absence of these transfers, but is much buttressed and intensified by them. Aid increases the power, resources and patronage of governments compared with the rest of society and therefore their power over it.24/
>
> Official aid retards development in many other ways, some of which will be considered briefly and one at great length. As already mentioned many, perhaps most, aid recipients much curtail the inflow and deployment of private capital...Such restrictions are anomalous, even perverse, in terms of such commonly declared objectives of aid as economic development and the relief of poverty or unemployment. They are perverse because shortage of development capital is often the basic argument advanced for aid. 25/

Often slow growth of various LDCs is "explained" by neo-Malthusian problems like population growth, lack of natural resources and overcrowding on agricultural land. Clearly, natural resources aid economic growth and, in the 1970s, oil helped a great deal. The impact of natural resources in the period from 1960-1980 was not, however, generally very large. Overcrowding on agricultural land, surprisingly, makes no difference whatsoever.

The effects of population growth need not be through strain on land or other natural resources; they can simply mean that it takes more capital, teachers, doctors, etc. to maintain a given standard of living. This seems to be the case for the LDCs; countries where the population grows faster tend economically to grow slower. The size of the impact is not that large. The average annual rate of increase of population in the LDCs was around 2.5 percent over the 1960-1980 period. If the rate of increase dropped to a tiny 0.5 percent, the numbers suggest per capita national product would have grown, at most, 0.6 percent faster per year. Actual economic growth rates over the period ranged from 7 percent per year down to -2 percent, with an average of 3 percent. So, lower birth rates do help, but they are not the most important factor.

The study looked at three dimensions of international economic conditions that affect LDC economies: 1) world prosperity; 2) world inflation; and 3) changes in the terms of trade of the LDCs, that is, the prices they receive for exports relative to the prices they pay for imports. General world prosperity affects the LDCs a great deal in the short run, but not over longer periods. World inflation showed no impact on LDC growth. The terms of trade may have an impact in the short run. However, for longer periods the terms of trade are probably not important and, therefore, it would be incorrect to blame lack of growth in the LDCs on changes in their terms of trade. Thus, world economic conditions cause fluctuations in LDC growth rates, but they are not an excuse for long-term slow growth.

The study also looked at political influences on economic growth. One frequent explanation given for slower growth of the LDCs is the lingering effects of colonialism. The statistical results show little or no continuing adverse effects of having been a colony. There is only weak evidence that the time span since a country became independent makes any difference.

Lack of industry, lack of natural resources, rapid population growth, world economic conditions, and colonialism are possible explanations for inadequate economic growth in the LDCs. Various researchers have considered one or more of them important causes of slow LDC growth. However, the hard statistical evidence shows they aren't that important, especially in the long run. We can therefore conclude that it must be government policy that is creating the gap between the "catch-up" potential and actual LDC performance.

The study also examined the effects of democracy, wars, and political stability on economic growth. It is frequently debated whether democracy is a luxury that the LDCs cannot afford. Certainly the growth-minded "Gang of Four" are not very democratic. The statistical evidence tends to support the view that democracy slows economic growth. Further tests need to be run on this question. The countries involved currently in serious wars, Lebanon, Indochina, Iran, etc., supply no current data; still, there is some evidence that wars have a negative impact on growth. Two measures of internal political instability were tried: 1) the incidence of coups and attempted coups and 2) the rate of political deaths. The incidence of coups is negatively related to economic growth.

Three important conclusions emerge from the research in this report. First, there is no natural vicious circle of poverty; the poorest of the LDCs can and should be growing faster than either the better-off LDCs or the developed countries. They can and should be closing the gap. Second, the failure of so many LDCs to realize their potential is not due to lack of resources, natural or man-made, but rather due to inefficient use of resources. Finally, the biggest cause of the inefficient use of resources and unnecessary slow growth of so many LDCs is big government. Their governments, with few exceptions, spend too much, tax too much, and over-regulate the private sector. A corollary of the last two conclusions is that foreign aid will not help the LDCs grow faster. Foreign aid encourages inefficient use of resources because it is other people's money being spent by governments. More important, foreign aid encourages big government. Most official aid goes directly to the governments, and even the little that does not is dispersed only with the governments' consent.

This study is the first attempt to do a comprehensive and rigorous analysis of all the factors influencing LDC growth.[26] It is to be hoped that it will add to the body of evidence from less rigorous studies and help convince the LDCs to reduce government spending and regulation in order to realize their potential.

NOTES

16. See Milton and Rose Friedman, Tyranny of the Status Quo, (New York: Harcourt Brace Javanovich, 1984).

17. See the World Development Report 1984, Appendix A.

18. Criticism of the performance of development economics and development economists has been attacked as being unjustified and as distracting attention from the main point to demonstrate the harm from big government in the LDCs. While development economists are now more critical of the government's role in LDC economies, there are still few studies coming out that examine the negative impact of government and many that suggest additional government spending and regulation would be helpful. The failure of development economics to look honestly at the negative role of government in economic growth is a serious failing that must be discussed.

19. See Moses Abramovitz, review of Towards an Explanation of Economic Growth, Journal of Economic Literature, (Nashville: American Economic Association, March 1983).

20. See Daniel Landau, "Government Expenditure and Economic Growth: A Cross-Country Study," Southern Economic Journal, (January 1983).

21. Ibid.

22. Hollis, Chenery, "The Structural Approach to Development Policy," American Economic Review, (May 1975).

23. See Daniel Landau, "Explaining Differences in Per Capita Income Between Countries: A Hypothesis and Test for 1950 and 1970," Explorations in Economic History, 1985 (forthcoming).

24. See P.T. Bauer, Equality, the Third World and Economic Delusion, (Cambridge, Mass: Harvard University Press, 1981).

25. Ibid. p. 106.

26. An extensive but not exhaustive literature search turned up three empirical papers studying the general relationship between government and economic growth: by this author, Gemmell, and Marsden. All are 1983 publications and none of their references are empirical studies of government and economic growth.

APPENDIX

DEFINITIONS OF REGRESSORS

A	The share of agriculture production in GDP, lagged average
ADS	Military expenditure as a share in GDP, lagged three-year average
AEDS	General government educational expenditure as a share in GDP, lagged three-year average
AEXRR	Index of the real exchange rate--1960=100, lagged three-year average
AGLPC	Agricultural land per capita
AINF	The inflation rate, lagged three-year average
AIP	Private investment as a share in GDP, lagged three-year average
AKES	General government capital expenditure as a share in GDP, lagged three-year average
AOFTS	Official transfers from abroad as a share in GDP, lagged three-year average, the proxy for foreign aid
APUTS	Private transfers from abroad as a share in GDP, lagged three-year average
AREVS	Current revenue as a share in GDP, lagged three-year average
ARIR	Real interest rate, lagged three-year average
ATRNS	General government current non consumption expenditure as a share in GDP, lagged three-year average
BREVS	General government budget deficit-total expenditure minus current revenue-as a share in GDP, lagged three-year average
COL	Dummy variable with a value of 1 if the country was a colony and 0 otherwise
COUP	Total of coups and attempted coups from 1948 to current year divided by the number of years since the coup or attempt

(con't)

DEMO	Dummy variable with a value of 1 if the country has been a democracy and 0 otherwise
DLP	Distance from the capital to the nearest seaport for landlocked countries only
DMSS	Percentage change in the money supply over the current period
DTRT	Change in the country's terms of trade
EDO	Weighted total of enrollment in primary, secondary, and higher education as a percentage of relevant age group, average for years 1965 and 1975
GDPWGR	Growth rate of world GDP average over the current period
LE7	Life expectancy at birth in 1970
LPOP	Population in millions, lagged
LRGDP	Real gross domestic product per capita. It is lagged one year in the annual regressions and an average of three years ending in the first year of four and seven-year period regressions
M	The share of manufacturing output in GDP, lagged average
O	other industry share in GDP, lagged average
OCSA	General government consumption expenditure other than defense and education, lagged three-year average
OIL	Dummy variable with a value of 1 if the country is a major oil producer and 0 otherwise
PDR	Political deaths-from internal situations-since 1948 per million of the population divided by the years since the deaths took place
PGR	Growth rate of the population in percent, average over the period studied
PIWGR	World inflation rate
RAIN	Average annual rainfall in inches
SEUR	Share of the population of European extraction

(con't)

T	Time trend
WFS	A dummy variable with a value of one if a war with a foreign country was fought on country's soil since 1940
YI	Years the country has been independent
---X	The regressor times LRGDP

TABLE 2.1

BASIC REGRESSIONS

Regression No.	1				2				3		
Subsample	Small Annual				Large Annual				4 - Year Periods		
I.V.	b	t	P.V.	I.V.	b	t	P.V.	I.V.	b	t	P.V.
AIP	.153	3.08	.002		.059	1.51	.13		.059	1.37	.17
LRGDP	-.305	5.14	.0001		-.310	6.13	.0001		-.311	4.80	.0001
GDPWGR	.302	2.88	.004		.238	2.77	.006				
OCSA	-.241	3.07	.002		-.125	2.93	.004		-.183	2.70	.008
AEDS	.169	1.52	.129		.083	.83	.40		-.067	.46	.64
ADS	.056	.607	.54		-.008	.14	.88		-.030	.34	.73
ATRNS	.104	2.63	.009		-.011	.32	.75		.083	1.14	.25
AKES	.011	.27	.79		.005	.14	.88		.004	.08	.94
DMSS	-.017	1.12	.26		-.016	1.52	.13	INF	-.0069	1.80	.07
LPOP	.0013	.61	.54		.0003	.17	.86		-.008	3.34	.001
PGR	-.398	2.55	.01		-.18	1.50	.13		-.262	1.35	.18
LE7	.150	3.39	.0008		.143	4.83	.001	EDO	.032	4.87	.0001
T	.000	.000	.99		.019	.60	.55		.029	.76	.45
AOFTS	.077	1.09	.28		.133	2.13	.033		-.021	.29	.77
DEMO	-2.41	3.94	.0001		-.178	3.65	.0003	DLP	-.004	2.74	.007
AEXRR	.0073	1.40	.161		.0089	2.10	.036	RAIN	-.011	1.58	.12
COUP	-.405	2.79	.005		-.261	2.24	.025				
OIL	2.06	3.03	.003		1.10	1.77	.077		1.61	1.88	.06
APUTS	.090	4.04	.0001		.039	2.86	.004		.030	1.43	.15
WFS	-.708	1.93	.054	A	.020	.92	.36				
ARIR	.056	3.70	.0002	M	.105	2.81	.005				
				O	.082	2.85	.005				
				AINF	-.007	2.70	.007				
				SEUR	.019	2.79	.005				
INT	-4.11	1.58	.12		-7.51	3.12	.002		3.46	2.92	.004
R2	.629				.472				.714		
D.F.	467				800				133		
D.W.	1.86				1.77				1.12		
B.T.*	.21				.66				.50		

*Bartlett's Test with 4 degrees of freedom.

TABLE 2.1 (CON'T)

BASIC REGRESSIONS

Regression No.	4		
Subsample	7 - Year Periods		
I.V.	b	t	P.V.
AIP	.082	1.73	.088
LRGDP	-.288	3.94	.0002
OCSA	-.243	3.03	.003
AEDS	-.022	.14	.89
ADS	-.236	2.51	.014
ATRNS	.082	1.83	.071
AKES	.016	.33	.74
LPOP	-.0068	2.64	.010
PGR	-.199	.93	.36
EDO	.022	2.56	.012
T	.021	.46	.65
AOFTS	.169	2.39	.019
DLP	-.005	2.57	.01
INT	3.44	2.52	.014
R2	.717		
D.F.	84		
D.W.	1.92		
B.T.	.40		

TABLE 2.2

MAJOR RESULTS SUMMARIZED

Included in Regression	I.V.	Subsample: Small Annual b	t	Large Annual b	t	4-Year Periods b	t	7-Year Periods b	t
Panel A: Current Consumption Expenditure—Other than Education or Military—as a Share in GDP									
Table 5 AIP, AREVS, BREVS	OCSA	-.196	1.86	-.07[illegible]	1.18	-.114	1.47	-.300	3.10
Table 2 AIP, no AREVS, BREVS		-.241	3.07	-.1[illegible]	2.93	-.183	2.70	-.243	3.03
Table 6 No AIP, AREVS, BREVS		-.234	2.96	-.126	2.96	-.172	2.54	-.230	2.85
Panel B: Government Educational Expenditure as a Share in GDP									
Table 5 LE7, AREVS, BREVS	AEDS	.173	1.24	.147	1.26	.001	.0009*	-.065	.38*
Table 2 LE7, No AREVS, BREVS		.169	1.52	.083	.83	-.067	.46*	.022	.14*
Table 7 AEDS only		.131	1.18	.073	.72	.036	.23	.147	.93
Table 7 EDO only		.018	2.39	.025	4.64	.032	4.87	.022	2.75
Panel C: Military Expenditure as a Share in GDP									
Table 5 AIP, AREVS, BREVS	ADS	.074	.73	.059	.88	.087	.84	-.270	2.75
Table 2 AIP, No. AREVS, BREVS		.056	.67	-.008	.14	-.030	.34	-.236	2.51
Table 6 No AIP, AREVS, BREVS		.048	.51	-.003	.06	-.037	.43	-.227	2.39
Panel D: Transfers and Other Current Nonconsumption Expenditure as a Share in GDP									
Table 5 AIP, AREVS, BREVS	ATRNS	.081	1.80	-.018	.48	.166	1.74	.052	1.02
Table 2 AIP, No AREVS, BREVS		.104	2.63	-.011	.32	.083	1.14	.082	1.83
Table 6 No AIP, AREVS, BREVS		.085	2.17	-.022	.68	.064	.89	.058	1.33
Panel E: Government Capital Expenditure as a Share in GDP									
Table 5 AIP, AREVS, BREVS	AKES	.146	1.16	.173	1.56	.098	1.24	-.027	.33
Table 2 AIP, No AREVS, BREVS		.011	.27	.005	.14	.004	.08	.016	.33
Table 6 No AIP, AREVS, BREVS		-.069	1.91	-.024	.78	-.021	.47	-.011	.25
Panel F: Official Transfers Received as a Share in GDP									
Table 5 AIP, AREVS, BREVS	AOFTS	.136	1.76	.146	2.31	-.052	.74	.216	2.88
Table 2 AIP, No AREVS, BREVS		.077	1.09	.133	2.13	.021	.29	.169	2.39
Table 8 No. Gov. Exp., AIP		.026	.51	.101	1.92	-.089	1.61	-.008	.15
Panel G: Private Transfers Received as a Share in GDP									
Table 5 AIP, AREVS, BREVS	APUTS	.097	4.29	.040	2.92	.030	1.48		
Table 2 AIP, No AREVS, BREVS		.090	4.04	.039	2.86	.030	1.43	.005	.25**
Table 8 No Gov. Exp., AIP		.093	4.11	.039	2.84	.027	1.30		

TABLE 2.2

MAJOR RESULTS SUMMARIZED

Included in Regression	I.V.	Subsample: Small Annual b	t	Large Annual b	t	4-Year Periods b	t	7-Year Periods b	t
Panel A: Current Consumption Expenditure—Other than Education or Military—as a Share in GDP									
Table 5 AIP, AREVS, BREVS	OCSA	-.196	1.86	-.076	1.18	-.114	1.47	-.300	3.10
Table 2 AIP, no AREVS, BREVS		-.241	3.07	-.125	2.93	-.183	2.70	-.243	3.03
Table 6 No AIP, AREVS, BREVS		-.234	2.96	-.126	2.96	-.172	2.54	-.230	2.85
Panel B: Government Educational Expenditure as a Share in GDP									
Table 5 LE7, AREVS, BREVS	AEDS	.173	1.24	.147	1.26	.001	.0009*	-.065	.38*
Table 2 LE7, No AREVS, BREVS		.169	1.52	.083	.83	-.067	.46*	.022	.14*
Table 7 AEDS only		.131	1.18	.073	.72	.036	.23	.147	.93
Table 7 EDO only		.018	2.39	.025	4.64	.032	4.87	.022	2.75
Panel C: Military Expenditure as a Share in GDP									
Table 5 AIP, AREVS, BREVS	ADS	.074	.73	.059	.88	.087	.84	-.270	2.75
Table 2 AIP, No. AREVS, BREVS		.056	.67	-.008	.14	-.030	.34	-.236	2.51
Table 6 No AIP, AREVS, BREVS		.048	.51	-.003	.06	-.037	.43	-.227	2.39
Panel D: Transfers and Other Current Nonconsumption Expenditure as a Share in GDP									
Table 5 AIP, AREVS, BREVS	ATRNS	.081	1.80	-.018	.48	.166	1.74	.052	1.02
Table 2 AIP, No AREVS, BREVS		.104	2.63	-.011	.32	.083	1.14	.082	1.83
Table 6 No AIP, AREVS, BREVS		.085	2.17	-.022	.68	.064	.89	.058	1.33
Panel E: Government Capital Expenditure as a Share in GDP									
Table 5 AIP, AREVS, BREVS	AKES	.146	1.16	.173	1.56	.098	1.24	-.027	.33
Table 2 AIP, No AREVS, BREVS		.011	.27	.005	.14	.004	.08	.016	.33
Table 6 No AIP, AREVS, BREVS		-.069	1.91	-.024	.78	-.021	.47	-.011	.25
Panel F: Official Transfers Received as a Share in GDP									
Table 5 AIP, AREVS, BREVS	AOFTS	.136	1.76	.146	2.31	-.052	.74	.216	2.88
Table 2 AIP, No AREVS, BREVS		.077	1.09	.133	2.13	.021	.29	.169	2.39
Table 8 No. Gov. Exp., AIP		.026	.51	.101	1.92	-.089	1.61	-.008	.15
Panel G: Private Transfers Received as a Share in GDP									
Table 5 AIP, AREVS, BREVS	APUTS	.097	4.29	.040	2.92	.030	1.48		
Table 2 AIP, No AREVS, BREVS		.090	4.04	.039	2.86	.030	1.43	.005	.25**
Table 8 No Gov. Exp., AIP		.093	4.11	.039	2.84	.027	1.30		

*EDO not LE7

**APUTS was not statistically significant for 7-year periods. It was dropped from the basic regression in Table 2 and not tested further.

TABLE 2.3

SUMMARY OF RESULTS FOR OTHER VARIABLES OF INTEREST

Panel A: Structure of the Economy

Subsample	I.V.	b	t	I.V.	b	t	I.V.	b	t	R2	D.F.
Small Annual	A	.019	.56	M	-.021	.35	O	.018	.34	.628	426
Large Annual		.020	.92		.105	2.81		.082	2.85	.472	800
4-Year Periods		.028	.81		.008	.12		.061	1.33	.724	118
7-Year Periods		.003	.08		-.004	.06		.051	1.07	.730	77

Panel B: Major Oil Producer

	I.V.	b	t	R2	D.F.
Small Annual	OIL	2.06	3.03	.629	467
Large Annual		1.10	1.77	.472	800
4-Year Periods		1.61	1.88	.714	133
7-Year Periods		.111	.14	.717	83

Panel C: Agricultural Land Per Capita

Small Annual	AGLPC	.913	1.14	.628	428
Large Annual		.421	.89	.473	786
4-Year Periods		-.770	1.14	.715	127
7-Year Periods		-.249	.31	.715	80

Panel D: Population Growth Rate

Small Annual	PGR	-.398	2.55	.629	467
Large Annual		-.18	1.50	.472	800
4-Year Periods		-.262	1.35	.714	133
7-Year Periods		-.199	.93	.717	84

Panel E: Economies of Scale

Small Annual	LPOP	.0013	.61	.629	467
Large Annual		.0003	.17	.472	800
4-Year Periods		-.008	3.34	.714	133
7-Year Periods		-.007	2.64	.717	84

TABLE 2.3 (CONT'D)

SUMMARY OF RESULTS FOR OTHER VARIABLES OF INTEREST

Panel F: Growth Rate of World GDP

Subsample	I.V.	b	t	R2	D.F.
Small Annual	GDPWGR	.302	2.88	.629	467
Large Annual		.238	2.77	.472	800
4-Year Periods		.145	.80	.713	127
7-Year Periods		-.468	1.56	.725	83

Panel G: Change in Terms of Trade

Subsample	I.V.	b	t	R2	D.F.
Small Annual	DTRT	-.026	1.94	.631	428
Large Annual		-.006	.44	.473	786
4-Year Periods		-.006	.46	.713	127
7-Year Periods		.003	.13	.730	81

Panel H: World Inflation Rate

Subsample	I.V.	b	t	R2	D.F.
Small Annual	PIWGR	-.027	.031	.627	428
Large Annual		-.040	.60	.473	786
4-Year Periods		.096	.68	.713	127
7-Year Periods		.238	1.00	.718	80

Panel I: Country Was A Colony

Subsample	I.V.	b	t	R2	D.F.
Small Annual	COL	-.290	.51	.630	466
Large Annual		-.312	.72	.473	799
4-Year Periods		-.529	.77	.720	120
7-Year Periods		-.249	.31	.715	80

Panel J: Years the Country Has Been Independent

Subsample	I.V.	b	t	R2	D.F.
Small Annual	YI	.0006	.19	.629	466
Large Annual		.0005	.19	.473	786
4-Year Periods		-.0006	.17	.714	132
7-Year Periods		-.0003	.08	.717	83

TABLE 2.3 (CONT'D)

SUMMARY OF RESULTS FOR OTHER VARIABLES OF INTEREST

Panel K: Democracy

Subsample	I.V.	b	t	R2	D.F.
Small Annual	DEMO	-2.41	3.94	.629	467
Large Annual		-.178	3.65	.472	800
4-Year Periods		-.286	.43	.714	132
7-Year Periods		.74	1.02	.720	82

Panel L: Incidence of Coups

Subsample	I.V.	b	t	R2	D.F.
Small Annual	COUP	-.405	2.79	.629	467
Large Annual		-.261	2.24	.472	800
4-Year Periods		-.211	1.06	.716	132
7-Year Periods		.119	.73	.719	83

TABLE 2.4

CURRENT REVENUE AND DEFICITS

Regression No. 1				2			3			4	
Subsample Small Annual				Large Annual			4-Year Periods			7-Periods	
I.V.	b	t	I.V.	b	t	I.V.	b	t	I.V.	b	t
AIP	.143	2.85		.054	1.38		.080	1.90		.086	1.74
LRGDP	-.358	5.49		-.361	6.47		-.307	4.96		-.334	4.31
GDPWGR	.299	2.85		.232	2.70						
OCSA	-.196	1.86		.076	1.18		-.114	1.47		-.300	3.10
AEDS	.173	1.24		.147	1.26		.0001	.0009		-.064	.38
ADS	.074	.73		.059	.88		.087	.83		-.270	2.75
ATRNS	.081	1.80		-.018	.48		.167	1.74		-.052	1.02
AKES	.146	1.16		.172	1.55		.098	1.24		-.028	.33
DMSS	-.016	1.10		-.016	1.51	INF	-.007	1.89			
LPOP	.0007	.33		.00003	.01		-.008	3.43		-.007	2.72
PGR	-.42	2.69		-.181	1.53		-.225	1.20		-.181	.85
LE7	.146	3.32		.134	4.45	EDO	.031	4.80	EDO	.021	2.44
T	.020	.43		.031	.96		.020	.54		.028	.59
AOFTS	.136	1.76		.146	2.31		-.052	.74		.216	2.88
DEMO	-2.23	3.52		-1.66	3.38	DLP	-.003	2.03	DLP	-.005	2.64
AEXRR	.006	1.06		.008	1.96	RAIN	-.010	1.49			
COUP	-.330	2.19		-.242	2.07						
OIL	1.62	2.26		.79	1.23		1.61	1.97			
APUTS	.097	4.29		.040	2.92		.030	1.48			
WFS	-.66	1.78	A	.008	.38						
ARIR	.059	3.88	M	.083	2.18						
			O	.068	2.28						
			AINF	-.007	2.57						
			SEUF	[illegible]	2.97						
AREVS	-.115	.92		-.151	1.39		-.079	1.12		.087	1.40
BREVS	-.174	1.46		-.190	1.85		-.066	1.48		-.019	.41
INT	-1.64	.55		-3.82	1.23		3.19	2.74		3.41	2.44
R2	.632			.478			.741			.728	
D.F.	465			798			129			82	
D-W	1.87			1.78			2.01			1.95	

TABLE 2.5

NET EFFECTS OF GOVERNMENT CAPITAL EXPENDITURES

Regression No. 1				2			3			4	
Subsample Small Annual				Large Annual			4-Year Periods			7-Periods	
I.V.	b	t	I.V.	b	t	I.V.	b	t	I.V.	b	t
LRGDP	-.264	4.51		-.285	5.97		-.281	4.59		-.251	3.55
GDPWGR	.302	2.86		.239	.279						
OCSA	-.234	2.96		-.127	3.96		-.173	2.55		-.230	2.85
AEDS	.139	1.25		.084	.85		-.047	.32		.033	.21
ADS	-.048	.51		-.003	.07		-.037	.43		-.226	2.39
ATRNS	.086	2.17		-.023	.68		.064	.89		.057	1.33
AKES	-.069	1.91		-.024	.79		-.021	.47		-.011	.25
DMSS	-.019	1.30		-.017	1.61						
LPOP	.002	1.01		.0004	.22		-.008	3.19		-.006	2.49
PGR	-.331	2.13		-.148	1.26		-.247	1.27		-.180	.83
LE7	.193	4.60		.148	4.98	EDO	.034	5.03	EDO	.023	2.78
T	.053	1.25		.027	.90		.044	1.16		.036	.79
AOFTS	.068	.94		.141	2.25		-.025	.34		.151	2.13
DEMO	-2.69	4.41		-1.74	3.57	DLP	-.0036	2.62	DLP	-.0046	2.39
AEXRR	.005	.90		.009	2.07	RAIN	-.012	1.58			
COUP	-.461	3.17		-.297	2.62						
OIL	2.36	3.48		1.08	1.73		1.51	1.77			
APUTS	.097	4.33		.039	2.83		.028	1.34			
WFS	-.65	1.74	A	.019	.90						
ARIR	.065	4.36	M	.110	2.96						
			O	.086	2.99						
			AINF	-.008	3.15						
			SEUR	.019	2.86						
INT	-.488	1.86		-7.30	3.04		3.75	3.21		3.79	2.77
R2	.622			.471			.710			.707	
D.F.	468			801			134			85	
D-W	1.83			1.77			2.15			1.87	

TABLE 2.6

EDUCATION

Regression No.	1			2			3			4	
Subsample	Small Annual			Small Annual			Large Annual			Large Annual	
I.V.	b	t	I.V.	b	t	I.V.	b	t	I.V.	b	t
AIP	.208	4.37		.159	3.18		.076	1.93		.065	1.66
LRGDP	-.180	3.83		-.260	4.71		-.237	4.85		-.283	5.73
GDPWGR	.298	2.81		.290	2.75		.243	2.79		.231	2.68
OCSA	-.298	3.84		-.249	3.13		-.145	3.38		-.116	2.70
AEDS	.131	1.18					.072	.72			
ADS	.054	.59		.047	.51		-.049	.95		-.039	.78
ATRNS	.131	3.35		.103	2.53		-.008	.24		-.007	.20
AKES	.040	.90		.022	.49		.011	.31		.005	.14
DMSS	.013	.89		-.016	1.10		-.014	1.37		-.016	1.53
LPOP	-.0022	1.19		-.002	1.32		-.0019	1.07		-.002	1.22
PGR	-.54	3.63		-.457	2.92		-.250	2.09		-.156	1.30
EDO				.017	2.38					.025	4.64
T	-.065	1.56		-.005	.12		-.005	.17		.022	.71
AOFTS	.085	1.18		.051	.72		.093	1.49		.117	1.92
DEMO	-1.05	2.25		-1.55	2.97		-.669	1.53		-1.32	2.99
AEXRR	.010	2.06		.009	1.89		.011	2.59		.010	2.40
COUP	-.44	3.00		-.550	3.76		-.327	2.80		-.366	3.20
OIL	1.02	1.67		1.56	2.37		.907	1.44		.89	1.46
APUTS	.089	3.96		.092	4.11		.036	2.62		.036	2.63
WFS	-.533	1.45		-.530	1.45	A	-.011	.56		.018	.88
ARIR	.053	3.48		.056	3.69	M	.121	3.22		.087	2.33
						O	.042	1.50		.072	2.54
						AINF	-.007	2.67		-.007	2.80
						SEUR	.023	3.54		.015	2.36
INT	3.46	2.54		2.36	1.63		1.01	.61		-2.11	1.21
R2	.620			.623			.457			.470	
D.F.	468			468			801			801	
D-W	1.84			1.86			1.71			1.76	

TABLE 2.6 (CONT'D)

EDUCATION

Regression No.	5			6			7			8	
Subsample	4-Year Periods			4-Year Periods			7-Year Periods			7-Year Periods	
I.V.	b	t	I.V.	b	t	I.V.	b	t	I.V.	b	t
AIP	.081	1.75		.056	1.32		.099	2.02		.083	1.74
LRGDP	-.126	2.21		-.307	4.78		-.167	2.90		-.290	4.16
OCSA	-.236	3.25		-.182	2.68		-.254	3.08		-.244	3.07
AEDS	.036	.23					.147	.93			
ADS	.028	.31		-.032	.38		.176	1.87		-.238	2.62
ATRNS	.100	1.28		.078	1.10		.102	2.21		.083	1.84
AKES	.007	.14		-.003	.06		.007	.13		.018	.41
AINF	-.0068	1.63		-.0069	1.80						
LPOP	-.0069	2.65		-.0078	3.32		-.0058	2.22		-.0068	2.76
PGR	-.385	1.84		-.269	1.39		-.357	1.68		-.195	.92
EDO				.032	4.87					.022	2.75
T	-.034	.86		.027	.71		-.021	.48		.023	.55
AOFTS	-.036	.46		-.024	.33		.164	2.25		.170	2.44
DLP	-.004	2.71		-.003	2.71		-.004	2.20			
RAIN	-.0006	.82		-.011	1.65						
OIL	1.18	1.29		1.65	1.95						
APUTS	.029	1.29		.028	1.37						
INT	6.11	5.37		3.42	2.90		5.30	4.43		3.44	2.53
R2	.662			.713			.694			.716	
D.F.	134			134			85			85	
D-W	2.19			2.11			1.96			1.91	

TABLE 2.7

NET EFFECT OF FOREIGN OFFICIAL AID

Regression No.	1			2			3			4	
Subsample	Small Annual			Large Annual			4-Year Periods			7-Year Periods	
I.V.	b	t	I.V.	b	t	I.V.	b	t	I.V.	b	t
LRGDP	-.286	4.92		-.273	6.30		-.267	4.65		-.212	3.04
GDPWGR	.298	2.78		.231	2.67						
DMSS	-.015	1.04		-.014	1.38						
LPOP	.004	2.23		.0014	.78		-.0062	2.67		-.005	1.96
PGR	-.314	2.03		-.145	1.24		-.262	1.41		-.197	.87
LE7	.299	5.57		.155	5.34	EDO	.035	5.62	EDO	.022	2.78
T	.060	1.42		.019	.64		.038	1.04		.0055	.12
AOFTS	.025	.51		.101	1.91		-.089	1.60		-.008	.14
DEMO	-3.44	6.24		-1.88	4.06	DLP	-.0028	2.09	DLP	-.0036	1.82
AEXRR	.0085	1.67		.010	2.48	RAIN	-.010	1.47			
COUP	-.401	2.92		-.267	2.39						
OIL	2.34	3.55		1.13	1.84		1.59	1.89			
APUTS	.092	4.10		.039	2.84		.027	1.30			
WFS	-.267	.77	A	.016	.79						
ARIR	.063	4.25	M	.104	2.87						
			O	.078	2.76						
			AINF	-.0078	3.09						
			SEUF	.015	2.43						
INT	-8.38	3.65		-8.44	3.65		2.13	2.18		2.33	1.80
R2	.604			.462			.694			.659	
D.F.	473			806			139			90	
D-W	1.74			1.72			2.03			1.83	

TABLE 2.8

COMPARISON OF COEFFICIENTS WITHOUT AND WITH INCOME INTERACTION TERMS IN THE REGRESSION

Included in the Regressions		Subsample									
		Small Annual					Large Annual				
		Without		With		Combined at Mean	Without		With		Combined at Mean
	I.V.	b	t	b	t	b	t	b	t	b	b
Panel A: Governmcnt Consumption Expenditures Other than Education or Military as a Share in GDP											
No AIP, AIPX	OCSA	-.234	2.96	-3.70	2.51		-.126	2.96	-.148	2.25	
Panel B: Education											
AEDS, AEDSX Only	AEDS	.131	1.18	.278	1.15	.217	.073	.72	.088	.89	
	AEDSX			-.018	.34						
EDO EDOX Only	EDO	.018	2.39	.010	1.01	.023	.025	4.64	.014	2.03	.025
	EDOX			.0037	1.93				.0034	2.16	
Panel C: Military Expenditure as a Share in GDP											
No AIP, AIPX	ADS	.048	.51	.097	1.06		-.003	.06	.189	2.90	
Panel D: Transfers and Other Current Nonconsumption Government Expenditure as a Share in GDP											
No AIP, AIPX	ATRNS	.085	2.17	.057	1.37		-.022	.68	-.004	.12	
Panel E: Government Capital Expenditure as a Share in GDP											
No AIP, AIPX	AKES	-.069	1.91	.142	1.81	.002	-.024	.78	.036	.69	-.033
	AKESX			-.039	2.20				-.021	1.69	

<u>Panel F: Official Transfers Received as a Share in GDP</u>												
No Government Expenditures, AIP	AOFTS	.026	.51	.017	.35			.101	1.92	.150	2.17	.104
	AOFTSX									.014	.94	
<u>Panel G: Private Transfers Received as a Share in GDP</u>												
No Government Expenditures, AIP	APUTS	.093	4.11	.104	4.68			.039	2.84	.048	3.37	

TABLE 2.9

SMALL ANNUAL SUBSAMPLE REGRESSIONS WITH INCOME INTERNATION TERMS

Regression No.	1		2		3			4	
Regression Type	Basic		Dropping AIP, AIPX		Dropping LE7, LE7X			EDO, EDOX	
I.V.	b	t	b	t	b	t	I.V.	b	t
AIP	.311	3.59			.187	2.8		.239	2.79
AIPX	-.058	2.91			-.012	.94		-.044	2.30
LRGDP	-.713	7.74	-.712	7.72	-.557	6.57		-.687	7.56
GDPWGR	.266	2.65	.267	2.63	.267	2.61		.249	2.47
OCSA	-.419	2.85	-.370	2.51	-.621	4.37		-.516	3.98
OCSAX	.085	2.14	.072	1.82	.138	3.59		.133	3.94
AEDS	.418	1.72	.360	1.49	.278	1.15			
AEDSX	-.059	1.03	-.035	.64	-.018	.34			
ADS	.110	1.21	.097	1.06	.080	.88		.100	1.10
ATRNS	.057	1.37	.027	.67	.085	2.05		.042	.99
AKES	.142	1.81	-.027	.43	.055	.76		.080	1.03
AKESX	-.039	2.20	-.0063	.44	-.012	.78		-.024	1.42
DMSS	-.048	1.75	-.063	2.32	-.064	2.32		-.055	2.04
DMSSX	.010	1.40	.015	2.22	.017	2.45		.013	1.87
LPOP	-.010	2.74	-.008	2.25	-.013	4.01		-.016	4.84
LPOPX	.0074	3.94	.0065	3.68	.0077	4.14		.0094	4.91
PGR	-.331	2.12	-.280	1.79	-.529	3.54		-.391	2.55
LE7	.031	.59	.132	2.95			EDO	.010	1.01
LE7X	.023	3.24	.007	1.52			EDOX	.0037	1.93
T	-.0006	.01	.037	.89	-.052	1.26		.022	.51
AOFTS	.076	1.04	.030	.42	.089	1.21		.047	.64
DEMO	-1.57	2.45	-2.09	3.31	-.82	1.72		-1.21	2.30
AEXRR	.009	1.78	.0067	1.29	.0085	1.66		.008	1.59
COUP	-.340	2.42	-.375	2.65	-.378	2.65		-.512	3.65
OD	2.21	3.32	2.40	3.61	1.37	2.27		1.89	2.91
APUTS	.074	3.15	.098	4.34	.084	3.57		.079	3.33

WFS	-1.88	2.84	-1.53	2.34	-1.45	2.19	-1.44	2.22
WFSX	.458	2.88	.327	2.25	.400	2.51	.412	2.68
ARIR	.041	2.75	.045	3.04	.038	2.53	.046	3.11
INT	.011	.004	-1.02	.39	5.89	4.23	4.29	2.94
R^2	.674		.664		.660		.668	
D.F.	459		461		461		461	
D-W	1.95		1.89		1.89		1.92	
B.T.*	2.19							

*Bartlett's Test 4 Degrees of Freedom.

TABLE 2.10

LARGE ANNUAL SUBSAMPLE REGRESSIONS WITH INCOME INTERACTION TERMS

Regression No.	1		2		3			4	
Regression Type	Basic		Dropping AIP, AIPX		Dropping LE7, LE7X			EDO, EDOX	
I.V.	b	t	b	t	b	t	I.V.	b	t
AIP	.175	2.56			.114	1.90		.168	2.45
AIPX	-.025	2.07			-.005	.53		-.023	1.88
LRGDP	-.708	8.49	-.672	8.21	-.564	7.15		-.644	7.91
GDPWGR	.210	2.53	.218	2.63	.214	2.54		.202	2.43
OCSA	.141	2.15	-.148	2.25	-.244	3.90		-.184	2.90
AEDS	.091	.94	.108	1.11	.088	.89			
ADS	.204	3.12	.189	2.90	.176	2.65		.169	2.60
ATRNS	.020	.56	-.004	.12	.027	.75		.012	.35
AKES	.115	1.89	.036	.69	.028	.52		.070	1.17
AKESX	-.032	2.32	-.021	1.69	-.009	.73		-.019	1.39
DMSS	-.035	2.10	-.036	2.17	-.036	2.12		-.035	2.08
DMSSX	.0067	1.68	.0072	1.81	.0077	1.92		.0069	1.73
LPOP	-.0067	2.05	-.0061	1.90	-.0079	2.40		-.012	3.67
LPOPX	.004	2.21	.0037	2.11	.0033	1.82		.0065	3.31
PGR	-.473	2.37	-.454	2.27	-.474	2.37		-.394	1.98
PGRX	.089	1.93	.089	1.94	.065	1.43		.071	1.57
A	.003	.14	.002	.09	-.030	1.38		-.004	.17
M	.028	.67	.051	1.24	.021	.51		.006	.15
O	.082	2.76	.088	2.97	.038	1.36		.071	2.41
AINF	-.007	2.80	-.008	3.10	-.008	3.26		-.008	3.10
SEUR	.011	1.60	.012	1.79	.020	2.93		.007	.91
LE7	.087	2.37	.119	3.44			EDO	.014	2.03
LE7X	.015	2.79	.0085	2.05			EDOX	.0034	2.16
T	-.059	1.23	-.018	.40	-.106	2.23		-.066	1.37
TX	.016	1.69	.011	1.16	.023	2.40		.018	1.86
AOFTS	.228	3.05	.243	3.26	.263	3.49		.207	2.74

AOFTSX	-.065	2.75	-.068	2.85	-.067	2.81	-.054	2.25
DEMO	-1.30	2.53	-1.39	2.73	-.467	1.05	-.815	1.78
AEXRR	.0096	2.31	.0084	2.02	.010	2.50	.010	2.49
COUP	-.445	2.17	-.581	2.93	-.54	2.66	-.542	2.67
COUPX	.065	1.23	.090	1.70	.072	1.33	.068	1.27
OD	.30	.47	.275	.43	.007	.01	-.051	.08
APUTS	.040	2.79	.042	2.98	.045	3.12	.036	2.50
AGLPC	-1.14	1.62	-.85	1.23	-2.44	3.74	-1.34	1.93
AGLPCX	.23	1.36	.179	1.04	.45	2.61	.227	1.28
INT	2.76	.98	-2.91	1.03	5.92	3.26	2.23	1.09
R^2	.537		.534		.523		.533	
D.F.	788		790		790		789	
D-W	1.84		1.83		1.78		1.82	
B.T.*	.18							

*Bartlett's Test 4 Degrees of Freedom.

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3.

REVIEW OF MAJOR STUDIES
OF FOREIGN ASSISTANCE
AND U.S. TRADE

By Economic Perspectives, Inc.

REVIEW OF MAJOR STUDIES OF FOREIGN ASSISTANCE AND U.S. TRADE

SUMMARY

Several major governmental and appointed bodies have reviewed U.S. foreign assistance programs of the past 25 years, each recommending actions to improve the effectiveness of that assistance in view of major concerns of the times. While few of the studies focused specifically on actions to promote private sector involvement in foreign economic development, all proffered recommendations relevant to private sector initiatives.

The rationale developed by these groups for foreign economic assistance changed over time in response to the changing political environment. In the early reports, countering the Communist expansion was the dominant goal, while later reports place more emphasis on political stability, world economic health, and business opportunities in the Third World.

The studies also reflect changing views about the most appropriate approach to development assistance. Early reports emphasize measures to expand investment and improve technical assistance, consistent with the Marshall Plan focus on aggregate production. However, by the 1970s, a greater concern with the distribution of the benefits of development became evident. Today, more emphasis is begin given to private sector development and market opportunities in developing countries.

While the rationale and emphasis of the studies have varied, there are several important recurring themes. All of the studies recommend measures to improve the flow of resources to developing countries through direct investment, financial capital, and the transfer of human services. In order to increase private investment in developing countries, many studies recommended actions to improve the investment climate in such countries, emphasizing the primacy of LDC government policies for development. U.S. actions to promote investment were encouraged, including greater use of government guaranties to reduce investors' risks, tax incentives for investment, and assistance in funding preliminary feasibility studies. The need to expand the private sector role in providing financial capital was commonly expressed, with several studies recommending greater assistance to local and intermediate financial institutions as a means of leveraging private capital. Most of the studies urged greater involvement of business, labor, and professional groups in developing countries to facilitate the development of skills needed by citizens of both less developed countries (LDCs) and the United States.

Most of the studies suggest actions to improve trade relations with and among LDCs, particularly to help LDCs expand their exports. Providing LDCs easier access to developed country markets through reduced tariffs and expanded quotas was a common recommendation. Several studies also urged the development of regional markets and free trade arrangements among developing countries. To help achieve the benefit of market opportunities, several studies recommended expanding the efforts of U.S. commmercial officers and Agency for International Development (AID) missions to actively assist the U.S. private sector in LDCs.

The studies contain many interesting suggestions. These include actions to stimulate private investment such as:

- allowing corporations to defer taxes on income earned in LDCs until profits are repatriated to the U.S.;
- allowing tax deductions for losses due to exchange rate fluctuations;
- purchasing nonvoting equity capital of LDC private enterprise; and
- extending risk guaranties and tax credits to portfolio investments of institutional investors.

Recommendations to improve the provision of human services include:

- providing tax credits and guaranties for exports of U.S. services as well as goods;
- augmenting salaries LDCs can pay advisors and firms for technical assistance; and
- encouraging LDCs to eliminate policies which limit royalties and impede repatriation of income.

To help U.S. firms identify business opportunities in developing countries, the most recent study recommended an informational campaign to inform U.S. companies of opportunities in the Third World, including "opportunity fairs," bilateral working committees of government and business leaders, and greater publicity of U.S. Government services available to firms abroad.

One study recommended restructuring the entire assistance program to increase its autonomy and effectiveness. The new approach would establish a U.S. development bank, operating as an independent government corporation, to finance projects and programs, and a U.S. development institute, operating as a government foundation, to coordinate public and private technical assistance. The same study also recommended reducing government restrictions on assistance to improve its utility and to help stimulate indigenous private sector development.

Taken together, the previous studies provide a useful perspective on actions to promote greater involvement of the private sector in development activities. In considering possible actions to stimulate private enterprise, it is prudent to consider the economic and political costs as well as potential benefits, balancing optimism about private sector initiative with skepticism about the effectiveness of policies, informed by a consideration of the concerns and conditions in particular recipient countries.

INTRODUCTION

Over the past 25 years, several major governmental and appointed bodies have been convened to examine U.S. foreign assistance (both economic and military) and the context in which and means by which it is carried out. Most have been composed of leaders in the private sector and government and have either been appointed by the President or convened under the legislative auspices of the foreign assistance acts. The specific focus of these bodies has varied widely, reflecting in large part the general economic and international political climate of the times. However, most have dealt primarily with U.S. Government actions and have tended to emphasize investment and financial assistance rather than commercial trade. Only a few have focused specifically on the roles of the private sector and private enterprise as principal instruments of foreign assistance and the economic development process.

This paper presents in summary form a review of reports of eight major studies conducted since the late 1950s. The purpose is to evaluate findings and recommendations that are of relevance to the work of the present Task Force. A brief introduction to the reports treated here is presented below.

- The Straus Report, Expanding Private Investment for Free World Economic Growth, 1959. This study was directed by Ralph I. Straus, a special consultant to the Undersecretary of State for Economic Affairs, and was conducted under the authority of the Mutual Security Act of 1954 which authorized a "...study of the ways and means in which the role of the private sector of the national economy can be more effectively utilized and protected, in carrying out the purposes of this Act."

- The Draper Committee Report, Economic Assistance Programs and Administration, July 1959. This committee was appointed by President Eisenhower to evaluate the mutual security programs, including both economic and military assistance and to recommend "the most suitable means whereby the free world's defenses may be insured." In its third report, the committee focused upon the U.S. economic assistance programs and their administration.

o The Clay Committee Report, The Scope and Distribution of United States Military and Economic Assistance Programs, March 1963. This committee was appointed by President Kennedy to examine the scope and distribution of U.S. foreign military and economic assistance and to recommend changes to enable an optimum contribution to strengthening the security of the United States and the free world.

o The Watson Committee Report, Foreign Aid Through Private Initiative, July 1965. This advisory committee was authorized by the Foreign Assistance Act of 1963 and empowered to "...carry out studies and make recommendations for achieving the most effective utilization of the private enterprise provisions of the Act."

o The Miner Committee Report, Trade and Investment in Developing Countries, April 1967. This committee was established by the National Export Expansion Council of the Department of Commerce and charged to seek ways that U.S. aid progams could make a greater contribution to U.S. export development objectives.

o The Peterson Task Force Report, U.S. Foreign Assistance in the 1970's: A New Approach, March 1970. This task force on international development was appointed by President Nixon to provide comprehensive recommendations concerning the role of the United States in assistance to less developed countries in the 1970s.

o The Williams Commission Report, United States International Economic Policy in an Interdependent World, July 1971. This commission on international trade and investment policy was appointed in 1970 by President Nixon and charged with examining the principal problems in U.S. trade and foreign investment and with producing recommendations designed to meet the challenges of the changing world in the 1970s.

o The Fowler-McCracken Commission Special Report, Government-Business Cooperation in the Developing World, Fall 1982. This commission on improving government-business cooperation in the conduct of U.S. international economic policy is sponsored by the International Management and Development Institute.

ASSESSMENT OF PREVIOUS REPORTS

The past commission reports on U.S. foreign assistance have been as much products as shapes of their times, generally reflecting the then dominant rationale for assistance. In the Cold War years, halting Communist expansion was the primary concern. Both the Draper Committee (1959) and the Clay Committee (1963) stressed the necessity of foreign economic assistance in maintaining the defenses of the free world against the spread of Communism. Later reports place much less emphasis upon this concern, giving greater attention to such benefits as political stability, a healthy world economy, and business opportunities which would derive from economic development in the Third World.

The Peterson and Williams reports, both commissioned in the early 1970s, reflect the change in rationale occurring in the years of detente and growing domestic economic problems. The Williams Commission treated development assistance in the broader context of international economic policy, stressing the interdependence of U.S. and world economic health. The Peterson study stressed the interdependence of developed and developing nations and the relationship of economic health and political stability. It stressed the "common concern" the United States shares with other nations for generating broad-based development, and specifically downplayed the need for "security measures that were once needed in a sharply divided world" but "which are not necessarily effective in today's world."

In the 1980s, concerns about the vitality of American business and growing trade deficits are influencing the rationale for foreign assistance. The Fowler-McCracken Commission's study (1982) placed great emphasis on the business opportunities in developing countries, particularly growing markets for American goods. While the emphasis is changed, the conclusions are less so, many resembling those made by the Miner Committee of the National Export Expansion Council 15 years earlier, which predictably emphasized market opportunities.

These previous studies also have reflected the dominant approach to development assistance. Optimism for the "take-off" of developing economies, fueled by the success of the Marshall Plan in postwar Europe and Japan, created high expectations for development efforts in the 1950s and 1960s. The approach was an augmented Marshall Plan, supplementing large capital investments with technical assistance to provide the resources and training necessary to expand aggregate production. Consistent with this approach, the earlier reports (through 1965) place the most emphasis on external investment and technical assistance.

Mounting evidence of increasing poverty in many developing nations in spite of some significant strides in expanding production contributed to increasing concern about the effectiveness of the traditional approach and more emphasis on the distribution of the benefits of development. The Peterson study reflects this evolution, stating "development is more than economic growth" and that "popular participation and the dispersion of the benefits of development among all groups in society are essential." Dissatisfaction with the traditional approach eventually culminated in the "New Directions" to assistance which dominated U.S. and World Bank policies during most of the 1970s. "Redistribution with growth" and satisfaction of "basic human needs" became the goals, with greater assistance provided for nutrition, health care, education, and rural development than formerly. It is notable that during these years no major studies were commissioned to examine private sector involvement in development activities.

Today, the approach appears again to be changing, with a much renewed emphasis on the role of the private sector. Both the Fowler-McCracken Commission and the present Task Force on International Private Enterprise exemplify this shift in approach, which gives priority to trade as well as investment opportunities in developing nations.

Although the emphasis of the previous studies has varied over the years, several important themes have been present throughout (see Appendix A). All of the studies recommend measures to improve the flow of resources to developing countries through direct investment, financial capital, and the transfer of human services. In order to increase private investment in developing countries, many studies recommended actions to improve the investment climate in such countries, emphasizing the primacy of LDC government policies for development. U.S. actions to promote investment were encouraged, including greater use of government guaranties to reduce investors' risks, tax incentives for investment, and assistance in f [illegible]ing preliminary feasibility studies. The need to expand the private sector role in providing financial capital was commonly expressed, with several studies recommending greater assistance to local and intermediate financial institutions as a means of leveraging private capital. Most of the studies urged greater involvement of business, labor, and professional groups in developing countries to facilitate the development of skills needed by LDC and U.S. citizens alike.

Most of the studies suggest actions to improve trade relations with and among LDCs, particularly to help LDCs expand their exports. Providing LDCs easier access to developed country markets through reduced tariffs and expanded quotas was a common recommendation. Several studies also urged the development of regional markets and free trade arrangements among developing countries. To help achieve the benefit of market opportunities, several studies recommended expanding the efforts of U.S. commercial officers and AID missions to actively assist the U.S. private sector in LDCs.

Other goals considered important include continuity in funding assistance and independence of operations from short-term political considerations, negotiation of investment treaties and agreement to arbitration of investment disputes, greater LDC responsibility for planning and financing development efforts, development of local institutions, greater international involvemment, improved coordination of development assistance with other U.S. policies, and clarification of U.S. laws applying to foreign enterprise such as antitrust laws and the Foreign Corrupt Practices Act.

Some of the other recommendations by past commissions are relevant to present private sector initiatives, particularly the recommendations by Straus and the Watson, Miner, and Fowler-McCracken commissions, which concentrated specifically on private enterprise, and those of the Peterson Task Force (see Appendix B). Straus provides detailed recommendations for increasing the flow of private direct investment and finance capital to developing countries, including a strong emphasis on tax incentives. Straus advocates special tax status for foreign business corporations (FBCs), allowing deferral of taxes on foreign generated income until profits are repatriated, deduction of losses to foreign subsidiaries and from exchange rate fluctuations, and allowing investors in LDCs to treat capital losses as deduction from ordinary income. To increase the capital available to local private enterprise, Straus recommended the novel approach of purchasing nonvoting equity capital of LDC private enterprises. Commercial bank activity would be encouraged by providing foreign branches the same tax advantages as FBCs, and by easing regulations on their operations, particularly those limiting ownership of stock in other corporations. Straus' other recommendations include measures to promote the formation of private investment companies, increase assistance to private financial institutions, ensure LDC investigation of private financing, and emphasize business in technical assistance activities.

The Watson Committee also focused on investment and finance, but with greater emphasis on means for expanding the role of the private sector in providing human services such as technical assistance. Recommendations include providing guaranties and tax credits for exports of U.S. services as well as goods, and creating an organization to attract private technical assistance coordinated with public assistance. Watson recommended generating more equity capital by extending risk guaranties and tax credits to portfolio investments of institutional investors and also urged the World Bank and Inter-American Development Bank to indemnify investors against risks of currency devaluations.

The Peterson Task Force also recommended establishing a development institute to operate as an independent foundation to coordinate research and technical activities with private organizations. In addition, it recommended establishing a development bank to operate as an independent government corporation supporting development programs formulated by LDCs, private enterprise, and international organizations. Peterson also argued for reduced procurement restrictions placed on assistance to make it more useful and to facilitate development of LDC private enterprise.

The Miner Committee focuses much more on expanding trade with developing countries, particularly to increase U.S. exports. It calls for expanded AID and Export-Import Bank programs and other means to provide adequate foreign exchange to LDCs to finance imports of U.S. goods and places more emphasis on U.S. export potential in AID programs generally. Where financing is not available from AID or Export-Import Bank, Miner would establish a "National Interest Fund" to finance exports to LDCs when the "national interest" is involved. The private sector role in technical assistance would be promoted by having the U.S. Government augment salaries and fees LDCs are able to pay advisors and consulting and engineering firms.

The Fowler-McCracken Commission, exploring the prospects for greater government and business cooperation in addressing the problems of the developing world, concentrated mainly on investment and trade. This commission sees great opportunities for trade and investment in the developing world, emphasizing informational approaches such as trade and investment "opportunity fairs," bilateral working committees of business and government officials, a national campaign to inform and involve small and medium-sized U.S. companies in business ventures in LDCs, educational programs in business schools and for the general public emphasizing the importance of international trade and the needs and goals of Third World people, and greater publicity of government services available to firms operating abroad. Private sector initiatives in providing human services would be encouraged by eliminating LDC policies which limit royalties and impede repatriation of income.

Taken together, the several previous studies provide a useful perspective on possible actions to promote involvement of the private sector in development activities. In evaluating the merits of these and other possible actions, it would be appropriate to consider not only potential benefits of new actions to stimulate private enterprise but the costs as well. In doing this, some of the relevant questions are: What activities must be given up if assistance efforts are redirected? Where is the U.S. comparative advantage in its activities? Is the United States better equipped to assist a specific sector, such as agriculture? What conflicts exist among policies to stimulate private enterprise, or between these and other development goals? For example, stimulation of U.S. exports may compete with growth of an indigenous private sector in LDCs. Tax incentives for investment may skew resource use toward greater capital intensity, adding to unemployment problems. What are the political costs of the approach? Can too great an emphasis on private enterprise lead to animosity and distrust of U.S. motives by LDCs, or renewed opposition to private enterprise if the actions fail to produce their advertised benefits?

Generating new efforts which are truly useful to both developing countries and the United States requires balancing optimism about the potential benefits to be derived from private sector development with a healthy skepticism about the effectiveness of such policies in light of the conditions and concerns prevalent in the specific circumstances of individual recipient countries.

APPENDIX A

SUMMARY OF GENERAL RECOMMENDATIONS

SUMMARY OF GENERAL RECOMMENDATIONS

PRIOR STUDIES RELATING TO PRIVATE ENTERPRISE IN DEVELOPMENT EFFORTS

Recommendations	Studies							
	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
U.S. Government Actions								
INCREASE DIRECT INVESTMENT								
1. Improve investment climate	x						x	x
o Oppose LDC expropriations of capital			x				x	
o Oppose LDC disincentives, such as ownership restrictions and limits on repatriated income			x	x			x	x
o Support firms in voicing concerns about arrangements with LDCs				x				
o Promote international arbitration of investment disputes				x			x	
o Promote investment treaties with LDCs							x	
o Promote international investment code				x				
o Ease U.S. antitrust and other related laws								x
o Clarify U.S. position on application/enforcement of antitrust laws	x							
o Promote unification of antitrust laws among nations				x				
2. Help initiate investment through market surveys and feasibility studies	x			x	x			x
3. Help minimize investment risk through insurance and guaranties	x	x	x	x	x	x	x	
o Increase availability of guaranties	x		x		x	x		
o Expand coverage of guaranties (e.g., to cover losses from war)	x							
o Improve guaranty terms (reduce/more flexible premiums, eliminate time limit)				x	x			
o Promote multilateral guaranties and insurance				x		x	x	
o Pressure LDCs to enter into guaranty agreements			x					
o Use banks or other private facilities as agents for guaranties					x			

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
4. Attract more investment through informational approach								
o Improve government information services to businesses in LDCs through U.S. embassies and economic missions								x
o Provide "one stop service" to potential investors and exporters seeking information about opportunities in LDCs and U.S. assistance								x
o Establish bilateral working committees of government and business officials to identify opportunities in LDCs								x
o Conduct AID studies to identify factors inhibiting investment in selected countries				x				
5. Promote investment through tax incentives	x	x			x	x		
o Allow U.S. firms operating in foreign countries to defer income taxes until profits distributed to shareholders or diverted from foreign uses	x							
o Allow such firms to deduct losses to foreign subsidiaries	x							
o Allow such firms to deduct losses due to exchange rate changes	x							
o Allow U.S. firms operating in LDCs to deduct capital losses from income	x							
o Allow shareholders to deduct capital losses from income	x							
o Exempt firms which receive 90 percent of their business in LDCs from penalty tax on personal holding companies	x							
o Increase tax credits for investments in LDCs				x				

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Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
	Studies							
o Allow more liberal recognition of foreign taxes on payments "in lieu of" incomé taxes	x							
o Expedite negotiations of tax treaties with "tax sparing" provisions	x							
o Reduce tax disincentives such as uncertainties caused by vague and abmiguous regulations					x			
o Establish a task force to design a program of tax inducements for exports to and investments in LDCs					x			
6. Promote investment of indigenous LDC funds								x
IMPROVE FLOW OF FINANCE CAPITAL								
1. Expand U.S. level of assistance				x		x		x
2. Promote expanded involvement of other industrialized nations			x					
3. Promote expanded private sector role								
o Promote development of local and regional investment companies	x					x		
o Use Government guaranties of loans in lieu of direct loans	x							
o Make loan guaranties more easily available				x				
o Offer guaranties and tax credits to portfolio investments of corporations and institutional investors				x				

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
o Permit corporations to defer taxes on amount of income equal to guaranties to institutional lenders of loans to foreign affiliates	x							
o Make loans to U.S. firms more easily available					x			
o Allow commercial banks to defer taxes on income received by foreign branches until income returned to domestic bank	x							
o Ease regulations on commercial bank operations in LDCs, particularly with respect to ownership of stock in foreign corporations	x							
o Provide most loans through commercial banks					x			
o Increase assistance to local and intermediate financial institutions	x			x		x		
o Increase assistance to American financial institutions promoting development	x							
4. Promote greater LDC responsibility for financing								
o Provide financing only to countries which are acting to mobilize their own resources and to build necessary institutions			x					
o Establish procedures requiring that LDCs explore private financial participation in proposed projects	x							
o Guarantee foreign official borrowing on international capital markets of LDCs becoming independent of concessionary loans						x		

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
	Studies							
5. Extend capacity of official assistance								
o Place stricter terms on loans to countries able to meet them			x					
o Base guaranty reserve requirements on maximum foreseeable cost	x					x		
6. Avoid debt crises								
o Promote better loan terms through multilateral lending agencies and from other nations						x		
o Promote better planning and early negotiations by IMF and World Bank to avoid crises						x		
7. Increase assistance to international financial institutions			x			x		
8. Increase flexibility and utility of assistance	x					x		
o Contribute actively to development of capital and credit markets in LDCs						x		
o Provide a range of lending facilities with terms adjusted to individual country circumstances						x		
o Provide loans for technical services as well as for capital						x		
o Reduce or eliminate procurement restrictions						x		
o Allow assistance in the form of nonvoting equity participation in private enterprise in LDCs	x							
o Allow more flexibility in terms of loans to d[illegible]rable business activity which otherwise would not be conducted					x			

Recommendations	Studies: Straus 1959	Draper 1959	Clay 1963	Watson 1965	Miner 1967	Peterson 1970	Williams 1971	Fowler-McCracken 1982
9. Improve continuity in assistance by establishing a continuing authorization for development loans, with multiyear appropriations		x						
10. Consider degree to which assistance contributes to broad based political and social, as well as economic, development						x		
IMPROVE HUMAN RESOURCE ASSISTANCE 1. Promote international trade in services								x
o Provide export credits and guaranties for trade in services as well as goods				x				
o "Top off" salaries LDCs are able to pay U.S. technical advisors and service firms to make the market competitive					x			
2. Increase role of private sector o Promote greater involvement of business, labor, universities, and professional societies in education and technical assistance programs		x	x	x	x	x		
o Assist in developing nonprofit institutions				x				
o Use facilities of subsidiaries of U.S. firms to provide training				x	x			

Recommendations	Studies: Straus 1959	Draper 1959	Clay 1963	Watson 1965	Miner 1967	Peterson 1970	Williams 1971	Fowler-McCracken 1982
3. Promote development of local capabilities								
o Emphasize development of local research capability in AID research efforts				x				
o Provide technical support for building of local institutions needed for development	x		x					
o Promote development of vocational and management schools				x				
o Put greater emphasis on supporting local and regional training centers		x						
4. Give LDCs greater responsibility for selecting, planning, and implementing technical assistance programs		x						
5. Increase support for multilateral assistance through U.N. technical assistance program		x						
6. Increase effectiveness of technical assistance								
o Support fewer, higher-quality projects			x					
o Support programs which will be accepted and continued by recipient in a reasonable period of time			x					
7. Improve continuity of technical assistance								

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
o Continue technical support beyond termination of concessionary development loans						x		
o Establish continuing authorization for technical assistance		x						
8. Emphasize business in educational programs	x							
o Train foreign students and teachers at U.S. business schools and related programs	x							
o Have U.S. business schools assist local institutions in training	x							
o Promote the establishment of trade, manufacturing, and management associations	x							
IMPROVE USE OF AGRICULTURAL COMMODITY ASSISTANCE								
1. Gear use of P.L. 480 more to foreign policy and development objectives		x						
o Vest primary responsibility for P.L. 480 with AID		x						
o Consolidate all sales of surplus agricultural commodities in one program		x						
o Expand use of Cooley loans		x	x	x	x			
o Increase flexibility of Cooley loan program		x			x			
2. Improve continuity by establishing multiyear appropriation for P.L. 480		x						

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
IMPROVE TRADE RELATIONS WITH LDCS								
1. Help LDCs expand exports to developed countries		x	x		x	x	x	
o Grant tariff preferences and greater quotas for products important to LDCs					x	x	x	
o Promote reduced barriers to LDC exports in other indus rialized countries					x	x	x	x
o Change laws and regulations which inhibit imports from LDCs					x			
o Expand AID programs to help LDCs expand exports					x			
o Increase AID efforts to help LDCs increase their earnings from tourism					x			
2. Encourage and support the development of free trade and regional markets among LDCs			x		x	x		
3. Pursue commodity agreements with LDCs							x	
4. Pursue commercial treaties with LDCs	x							
5. Increase awareness in U.S. of trade opportunities in LDCs and of their importance								x
o Set expansion of international trade as a national economic priority of great importance								x
o Educate the public of the importance of international trade to the U.S. and LDCs, and of the goals and needs of LDCs								x

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
o Institute a national campaign to inform and involve small and medium-size companies in trade with LDCs								x
o Provide greater publicity of U.S. embassy services in support of export activities of U.S. firms								x
6. Promote exports to LDCs								
o Consider export credit insurance	x							
o Expand programs of AID, Export-Import Bank, or other agencies to assist financing of imports of U.S. goods					x			x
o Expand availability of U.S.-owned local currency to firms importing any U.S. goods					x			
o Supplement trade promotion by providing assistance to U.S. firms for training local personnel					x			
o Increase cost sharing for export market surveys					x			
o Improve provision of commercial information through U.S. embassies, country desk officers, and AID missions	x				x			x
o Increase number and improve recruitment of U.S. commercial officers and promote more systematic contact with U.S. and foreign business communities by these officers	x				x			x
o Enlarge AID staff concerned with export promotion, and increase AID attention to the export promotion potential of its projects					x			
o Staff AID with people capable of dealing well with business as well as government				x				

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
	Studies							
7. Reduce U.S. disincentives to expanding trade								
o Reduce/avoid export controls								x
o Investigate impact of U.S. laws applying to foreign commerce								x
o Require "export impact evaluation" of new regulations								x
IMPROVE ORGANIZATION AND ADMINISTRATION OF ASSISTANCE								
1. Replace economic assistance structure with a new framework consisting of a development bank for financial assistance. a development institute for technical assistance, OPIC for promotion of investment, and a development council to coordinate development policy with other policies						x		
2. Increase coordination of assistance with other policies					x	x		
3. Create organization(s) to coordinate public and private technical assistance				x		x		
4. Provide program as well as project assistance through AID		x						
5. Increase AID attention to local private enterprise development	x	x						
o Make projects to develop private enterprise an integral part of AID programs	x	x						

Recommendations	Studies: Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
o Unify AID private enterprise support programs					x			
o Conduct AID country level studies upon which to base programs to stimulate private enterprise development	x							
6. Appoint high level group of private citizens to advise AID administrator on how to mobilize American private enterprise for development purposes		x						
7. Assign senior official in Department of State responsibility for promoting the role of private enterprise in development	x							
Private Sector Actions								
INCREASE INVESTMENT								
1. U.S. firms should increase their efforts to invest in LDCs					x			
o Give adequate attention to LDC opportunities in planning investments					x			
o Inform and avail themselves of U.S. government services to firms overseas					x			
o Promote better understanding and good will between business and LDCs					x			
o Be flexible in approach to investing in LDCs, including consideration of joint ventures and franchise arrangements with local businessmen					x			
o Participate in bilateral working committees of government and business leaders to identify opportunities								x

Recommendations	Straus 1959	Draper 1959	Clay 1963	Watson 1965	Miner 1967	Peterson 1970	Williams 1971	Fowler-McCracken 1982
o Promote use of "opportunity fairs" in which investors can discover opportunities in LDCs								x
2. Export expansion councils should pay more balanced attention to investment as well as exports					x			
IMPROVE CAPITAL FLOW								
1. U.S. businessmen should participate actively in development of assistance policies which promote economic growth in LDCs					x			
IMPROVE HUMAN RESOURCE ASSISTANCE								
1. U.S. firms should provide training facilities through their subsidiaries in LDCs					x			
2. U.S. firms should support development of adequate technical and business education facilities in LDCs					x			
3. Business, professional, and labor groups and universities should become more involved in exchanging experience with LDCs		x	x	x	x	x		
EXPAND TRADE								
1. U.S. firms should increase efforts to expand trade with LDCs					x			

Recommendations	Straus 1959	Draper 1959	Clay 1963	Watson 1965	Miner 1967	Peterson 1970	Williams 1971	Fowler-McCracken 1982
	Studies							
o Give greater attention to long-term market potential					x			
o Develop products to fit the special needs of LDCs					x			
2. Export expansion councils should expand programs to provide information on opportunities and methods of doing business in LDCs					x			
3. U.S. businessmen should actively participate in the development of government trade policies					x			
LDC Government Actions								
INCREASE INVESTMENT								
1. Improve investment climate					x		x	
o Avoid expropriation of capital			x				x	
o Remove disincentives such as ownership restrictions, fade-out requirements, and limits on repatriated earnings			x	x			x	x
o Change negative attitude about foreign investment					x			x
o Participate in investment treaties							x	
o Agree to international arbitration of investment disputes				x			x	
o Establish high-level mechanisms to enable investors to "short circuit" excessive bureaucracy								x
2. Help reduce investment risk by expanding provision of guaranties			x				x	

Recommendations	Straus: 1959	Draper: 1959	Clay: 1963	Watson: 1965	Miner: 1967	Peterson: 1970	Williams: 1971	Fowler-McCracken 1982
	Studies							
3. Help attract new investors by participating in opportunity fairs and bilateral working committees								x
4. Provide tax incentives for investment	x		x					
5. Be more practical in investment planning			x					
IMPROVE FLOW OF FINANCE CAPITAL								
1. Adopt more responsible monetary and fiscal policies			x					
2. Reduce subsidies to government enterprises			x					
3. Increase effort to promote development								x
o Promote investment of indigenous funds within country			x					
o Raise local tax revenue								x
o Provide new sources of credit to small and medium businesses			x					
o Build necessary infrastructure								
o Develop local institutions necessary for development			x					
IMPROVE TRANSFER OF HUMAN RESOURCES								
1. Enlist the support of industrial, financial, labor, farmer cooperative, and other leaders			x					

Recommendations	Straus 1959	Draper 1959	Clay 1963	Watson 1965	Miner 1967	Peterson 1970	Williams 1971	Fowler-McCracken 1982
	Studies							
IMPROVE TRADE RELATIONS								
1. Increase efforts to promote exports		x						
2. Develop free trade arrangements and regional markets with neighbors			x		x	x		
3. Pursue commodity agreements							x	

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APPENDIX B

SYNOPSES OF PREVIOUS REPORTS

STRAUS REPORT (March 1959)

EXPANDING PRIVATE INVESTMENT FOR FREE WORLD ECONOMIC GROWTH

Ralph I. Straus, Special Consultant to the Undersecretary of State for Economic Affairs

Charge-- Section 413(c) of the Mutual Security Act of 1954, as amended, authorizes a "study of the ways and means in which the role of the private sector of the national economy can be more effectively utilized and protected, in carrying out the purposes of this Act."

Recommendations

The report contains many detailed recommendations on how to increase the role of the private sector, particularly with respect to investment finance capital.

Increase Direct Investment

1. Improve investment clilmate by reducing uncertainty about the application of U.S. antitrust law through:

   o authoritative indication of the extent to which the Department of Justice will consider elements of legal or quasilegal compulsion or business necessity in assessing legality of arrangements;

   o clarification and more public information about the willingness of the U.S. Government to consider in advance the legality of proposed investments; and

   o provision of adequate time in actions by a foreign government against a U.S. business to permit consultatation or negotiation with representatives of the foreign government.

2. Help initiate investment by providing financing for market surveys and exploration through the Mutual Security Program.

3. Help minimize investment risk by:

   o amending the investment guaranty provision of the Mutual Security Act to include coverage of losses arising from insurrection, wars, and civil strife; and

   o doubling issuing authority for investment guaranties.

4. Increase tax incentives in the United States for all foreign investment by:

   o deferring U.S. income tax payments by Foreign Business Corporations (FBCs) until profits are actually distributed to U.S. stockholders or otherwise diverted from foreign uses;

   o seeking legislative support for a more liberal reading of the clause allowing a tax credit for foreign taxes paid "in lieu of" income taxes and conducting tax treaty negotiations to identify foreign taxes which are paid "in lieu of" income taxes;

   o allowing losses due to exchange rate changes to be recognized as ordinary losses for tax purposes; and

   o providing more rapid negotiation of tax treaties with "tax sparing" and similar provisions, and more liberal recognition of foreign taxes in allowing tax credits.

5. Increase tax incentives in the United States for investment in LDCs by:

   o allowing investors in LDCs to deduct capital losses from ordinary income and allowing capital losses of new FBC investment in an LDC to be carried through to shareholders and made available as a deduction against ordinary income;

   o deferring U.S. tax on sales of technical services in exchange for stock or securities of LDC companies until securities are sold;

   o deferring U.S. tax on sale of property in exchange for securities of LDC companies, provided the investor has at least 10 percent interest in the foreign company; and

   o considering exempting FBCs which receive 90 percent or more of their income in LDCs from penalty tax on personal holding companies.

Increase Flow of Finance Capital

1. Increase assistance to financial institutions by:

   o providing greater financial support to soundly organized foreign development banks; and

   o supplementing the resources of American financial institutions prepared to invest in private enterprises contributing to development in LDCs.

2. Help minimize risk of loans by:

   o using government guaranties of loans by private lenders more extensively in lieu of direct loans;

   o expanding programs to test the feasibility and effectiveness of loan guaranties;

   o basing reserve requirement on maximum foreseeable cost rather than 100 percent of guaranties; and

   o permitting a domestic corporation to defer its guaranty to institutional lenders of loans made to its foreign affiliates in LDCs.

3. Promote the formation of investment companies through:

   o government financial, tax, and legal support for formation of International Development Investment Companies;

   o consideration by the Small Business Administration and Congress of authorizing Small Business Investment Companies; and

   o allowing all regulated investment companies to pass available foreign tax credits through to shareholders.

4. Increase flexibility in government assistance by authorizing government financial assistance in the form of nonvoting equity participation in private enterprises abroad.

5. Promote commercial bank activity in LDCs by:

   o allowing U.S. banks to treat their branches in other countries as FBCs for tax purposes; and

   o easing Federal Reserve Board regulations of banks operating in LDCs as Edge Act Banks (which are permitted a greater range of activities than ordinary banks), particularly advance consent requirements for purchase of stock in other corporations.

6. Expand use of local currencies generated through P.L. 480 sales to promote private enterprise in LDCs by:

   o making clear that P.L. 480 local currencies are available for lending by the Development Loan Fund;

   o using the funds for grants to nonprofit organizations in LDCs which extend services to encourage local private enterprise;

o expanding the application of loans made under the Cooley amendment to permit loans to private enterprises owned by U.S. citizens living abroad or in which U.S. citizens own a substantial interest and to permit loans of excess funds to foreign countries after 18 months; and

o ensuring that any legislation to clarify the use of local funds for loans allows maximum use of the funds to encourage private enterprise and provides for supervision of such loans by a single U.S. Government agency in each country.

7. Promote private financial participation subsequent to assistance by:

o establishing procedures to assure consideration and exploration of private financial participation prior to extending financial assistance for government projects; and

o centralizing managerial responsibility for an entire project in a single operating company.

Improve Human Resource Assistance

1. Extend technical assistance to strengthen local institutions designed to assist private enterprise (industrial development centers, development banks) and to create new ones.

2. Emphasize business in assistance programs by:

o training foreign teachers and students at U.S. business schools;

o having U.S. business schools assist local institutions and train businessmen in foreign countries;

o providing similar arrangements for training in law, public administration, and economics which bears on the institutional framework for effective business activity overseas;

o providing programs for establishing trade, manufacturing, and business management associations; and

o providing on-the-job training in industrial plants.

Improve Trade Relations With LDCS

1. Continue attention to commercial treaty negotiations and pursue negotiations with other LDCs.

2. Consider the desirability of export credit insurance.

Improve Administration of Assistance to Promote Private Enterprise

1. Make projects to develop private enterprise an integral part of assistance programs.

2. Promote more systematic use of local and foreign business and financial communities by U.S. embassies and economic missions, and provide better economic and commercial staff in these missions.

3. Conduct analyses on which to base program of private sector development in selected countries.

4. Review Departments of State and Commerce services to business.

5. Assign a senior official in Department of State to be responsible for promoting the role of private enterprise in economic development by:

   - monitoring activities of operating agencies;

   - identifying useful projects; and

   - recommending legislative and administrative actions.

DRAPER REPORT (July 1959)

ECONOMIC ASSISTANCE PROGRAMS AND ADMINISTRATION
(Third Interim Report)

President's Committee to Study the United States Military Assistance Program

Charge-- Established in fall of 1958 by President Eisenhower to evaluate the Mutual Security Program, including both economic and military assistance and to recommend "the most suitable means whereby the free world's defenses may be insured."

In its Third Interim Report, the Draper Committee focused upon the U.S. economic assistance programs and administration.

General Conclusions

1. Economic and military assistance are complementary tools which are both essential in achieving foreign policy objectives and lasting world peace.

2. The United States must be more selective in using its scarce assistance resources, emphasizing projects which yield the greatest results in promoting the strength of the free world.

3. Review of assistance programs should emphasize the opportunity for other industrialized nations and private enterprise to play a larger role in assistance.

4. Responsibility for development rests primarily with developing countries themselves. Effective assistance requires adequate desire and determination in recipient nations. U.S. contributions must be closely related to recipient country efforts.

Recommendations

Improve Organization and Administration of Assistance

1. Consolidate assistance efforts in a single economic assistance agency which would:

   o be responsible for development of long-range economic assistance plans for individual countries and for coordinating U.S. economic assistance programs, subject to the direction of the Department of State;

   o be assigned the functions, facilities, and personnel of the International Cooperation Administration;

- manage the Development Loan Fund;

- manage agricultural commodity assistance programs under P.L. 480, including distribution of P.L. 480 grants and sales, and be responsible for extending loans repayable in foreign currencies and coordinating use of all local currencies; and

- take an active part in working with international organizations concerned with development.

2. Appoint a high-level group of private citizens to advise the head of the agency on how to mobilize American private enterprise for development purposes.

3. Provide for long-range planning for economic assistance, including a separate personnel system with a permanent career service.

4. Provide for more effective decentralization of responsibilities, including greater leadership by U.S. ambassadors for economic assistance plans and programs.

5. Balance strong foreign policy direction with clear operational responsibility vested in the assistance agency by:

   - ensuring Department of State participation in long-range planning, including approval by Secretary of State of budgetary requests;

   - allowing the agency freedom to implement its programs without prior approval;

   - strengthening Department of State staff and functions concerned with economic assistance programs; and

   - providing an evaluation staff for the head of the agency and an evaluation assistant to the Secretary of State.

Increase Investment

1. Help reduce risk through increased use of government guaranties of private loans and investments.

2. Promote private investment through additional tax incentives.

Provide Continuity in the Flow of Finance Capital

1. Provide a continuing authorization for Development Loan Fund operations and appropriate enough funds each year to cover total needs for the year plus a part of the succeeding two years.

Improve Human Resource Assistance

1. Stimulate greater recipient responsibility for selection, planning, and implementation of technical assistance projects.

2. Make maximum use of private companies, foundations, universities, and other nongovernment organizations through the Technical Cooperation Program.

3. Place greater emphasis on supporting local and regional training centers.

4. Improve continuity in technical assistance by providing a continuing authorization for it.

5. Increase support of U.N. technical assistance programs.

Improve Use of Agricultural Commodity Assistance for Development Purposes

1. Gear use of P.L. 480 more to advancement of foreign policy objectives, especially the objectives of the Mutual Security Program by:

   o using surplus commodities for economic development to the maximum extent possible, consistent with the capability of effective use by recipient countries and the need to protect U.S. agricultural sales and the agriculture of recipient countries;

   o vesting primary responsibilities for the P.L. 480 program with the new economic assistance agency;

   o authorizing more flexible use of P.L. 480 commodities so that they can be used more by grant with the establishment of a counterpart account or by sale with a loan or grant of local currency sales proceeds; and

   o consolidating all sales of agricultural surplus commodities for local currency as one program.

2. Improve continuity in the P.L. 480 program by providing at least three-year authorization for Title I and II operations in amounts large enough to permit long-range planning for use.

Expand Role of Multilateral Assistance

1. Consider bilateral and multilateral contributions together in determining assistance levels.

2. Continue support for existing international organizations and promote the establishment of the International Development Association.

3. Join with other interested Western countries and Japan on an ad hoc basis to deal with development problems of particular countries or regions.

Promote Development of Indigenous Private Enterprise

1. Employ every feasible means to assist and encourage the growth of local private enterprise.

Address Population Problem

1. Assist countries on request in formulation of plans to deal with the problem.

2. Increase assistance to local maternal and child welfare programs.

3. Strongly support studies leading to information useful in the formation of practical programs to address the problem.

Reduce Defense Support and Special Assistance

1. Continue needed defense support assistance but reduce assistance when made possible by:

   o substitution of development loans and agricultural commmodity assistance where practicable; or

   o changes in military or economic conditions in recipient countries.

2. Stimulate efforts in recipient countries to increase exports to reduce aid requirements.

CLAY REPORT (March 1963)

THE SCOPE AND DISTRIBUTION OF UNITED STATES MILITARY AND ECONOMIC ASSISTANCE PROGRAMS

The Committee to Strengthen the Security of the Free World

Charge-- Established in December 1962 by President Kennedy to examine the scope and distribution of U.S. foreign military and economic assistance and to recommend changes desirable for its optimum contribution to strengthening the security of the United States and the free world.

General Conclusions

1. Foreign assistance is essential to the national interests of the United States and to the curtailment of Communist efforts in all parts of the world.

2. Economic and social growth can be achieved only if it is based on an internal expression of will and discipline, without which aid is of little value. Many aid receiving countries have not performed well, and U.S. aid has not been adequately conditioned on such performance.

3. The process of economic development is a long one, limited by an absence of trained manpower and local institutions which limits the capacity of LDCs to absorb aid effectively.

4. U.S. assistance is trying to do too much for too many when a higher quality and reduced quantity of aid could accomplish more.

5. The U.S. is bearing too large a share of the aid burden, particularly in light of the growing economic strength in other industrialized nations and balance of payment deficits in the United States.

6. U.S. assistance should create economic units which mobilize the great potential and range of private efforts required for economic vitality and rapid growth.

Recommendations

The report contains a number of recommendations relative to the distribution of assistance among different areas which are here omitted. Included are a number of recommendations specifically addressed to the Alliance for Progress, but which the Committee views as applicable to aid in general.

Increase Direct Investment

1. Improve investment climate by opposing impediments to the growth of private enterprise such as doctrinaire biases against responsible private enterprise, and agitation for expropriation of foreign enterprises and nationalization of private productive ventures.

2. Help minimize investment risk by expanding investment guaranty programs (although Committee doubts the wisdom of guaranties against commercial risk) and considering reducing or eliminating aid to countries refusing to enter into investment guaranty agreements.

3. Encourage LDCs to adopt tax systems which stimulate private local and foreign investment.

4. Improve government investment planning in LDCs by striving for greater emphasis on practical implementation of consistent and sensible public policies to encourage growth in the private sector.

Improve Flow of Finance Capital

1. Promote greater LDC responsibility through changes in LDC policies, including:

   o monetary stability;

   o sound financial and social budgeting;

   o reduction of subsidies to government enterprises;

   o new sources of credit for medium and small businesses; and

   o tax systems to raise local revenue levels.

2. Provide U.S. financing of local costs only to countries moving to mobilize their own resources and to build the institutions and procedures necessary to channel them into productive investment.

3. Increase the multilateral effort to provide assistance, including

   o greater assistance by some industrialized nations;

   o improved loan terms through other lending nations' softening of terms and establishment of Organization for Economic Cooperation and Development (OECD) and World Bank of minimum standards for loan terms;

o increased use of the International Development Association as a common channel for aid funds; and

o limiting U.S. contributions to U.N. assistance agencies to proportionate share of regular U.N. assessment.

4. Extend capacity of bilateral assistance by:

o allowing more flexible terms on AID loans, including harder terms for loans to countries with adequate debt servicing capacity; and

o expanding use of the "Cooley loan" provision of the P.L. 480 program.

Improve Human Resource Assistance

1. Improve bilateral technical assistance by:

o focusing on fewer, higher-quality projects;

o selecting only programs which will be accepted and continued by the recipient country within a reasonable period of time;

o limiting new program starts until AID program review is completed; and

o tapping unused resources, particularly American universities in technical assistance efforts.

2. Encourage LDC governments to enlist the support of industrial, financial, labor, cooperatives, and other leaders in pursuit of development programs.

3. Provide technical support needed in building local institutions for development.

Improve Trade Relations With LDCs

1. Expand efforts to assist free trade and economic integration with and among LDCs, including wide nondiscriminatory access to the Common Market.

Improve Organization and Administration of Assistance

1. Reduce focus on bilateral assistance by:

o reducing number of AID overseas missions by consolidating into regional offices;

o reducing military assistance progressively as recipient nations' economic capacities improve; and o phasing in reductions in economic and military assistace programs.

2. <u>Provide flexibility</u> to meet unknown challenges by providing an ample <u>Contingency Fund</u> in the annual aid appropriation.

WATSON REPORT (July 1965)

FOREIGN AID THROUGH PRIVATE INITIATIVE

Advisory Committee on Private Enterprise in Foreign Aid

Membership--Nine members from U.S. business, labor, farming, academia, law, and engineering.

Charge--Foreign Assistance Act of 1963 established committee to "carry out studies and make recommendations for achieving the most effective utilization of the private enterprise provisions of the Act."

General Conclusions

1. Nongovernmental sources must play a greater part in providing needed capital for development. Governments cannot be expected to fill the resource gap.

2. Nongovernmental sources must be the major source of skills and human resources necessary to assist development. Governments do not have the required knowledge or capability.

3. The role of business, labor, and professional groups in development assistance must be expanded if development efforts are to be effective.

Recommendations

Private sector participation in the development process should be enhanced by U.S. actions to:

<u>Increase Direct Investment</u>

1. <u>Improve investment climate</u> by:

   o conducting AID study of key aid recipient countries to identify factors which may improve investment climate and implementing programs to address these factors;

   o accepting the principle of international arbitration for investment disputes. United States should ratify the International Convention for the Settlement of Investment Disputes;

   o supporting the establishment of an international investment code which specifies obligations of investors and host countries;

   o opposing restrictions on foreign ownership of capital in LDCs;

o lending support to investors who wish to voice concerns about arrangements with LDC governments; and

o collaborating with other nations to unify antitrust laws.

2. Help initiate investment by assisting in providing market and feasibility studies.

3. Help minimize investment risk by:

o expanding guaranty program by raising ceilngs, relaxing time limitations, allowing comprehensive insurance, and reducing rates; and

o urging the World Bank and Inter-American Development Bank to indemnify investors against risk of currency devaluation.

Increase Flow of Finance Capital

1. Increase assistance to financial institutions by:

o providing greater support to local financial institutions in LDCs;

o approving World Bank loan of $400 million to International Finance Corporation; and

o expanding use of U.S.-owned local currency to increase capital base of financial intermediaries.

2. Attract more U.S. investors by:

o making risk guaranties more easily available to U.S. investors by arranging with underwriter instead of ultimate buyer;

o offering portfolio investors extended risk guaranties with competitive risk yield features; and

o extending investment tax credits to portfolio investments of institutional and corporate investors.

3. Increase tax incentives in U.S. for investment in LDCs by:

o allowing U.S. corporations to offset losses from subsidiaries in LDCs as well as in the United States;

o ratifying U.S.-Thailand tax treaty giving investment credit to U.S. investors in Thailand and pursuing similar treaties with other LDCs; and

o enacting 30 percent tax credit for investment in LDCs.

Expand Private Sector Role in Provision of Human Services

1. Expand involvement of business, labor, universities, and professional societies in educational programs.

2. Promote transfer of industrial skills by:

   o partly financing technical assistance required for selected AID projects;

   o promoting development of management schools and vocational institutions in LDCs; and

   o investigating the use of facilities of U.S. subsidiaries for training, with AID support.

3. Provide export credits and guaranties for export of services as well as for export of goods.

4. Increase AID research efforts, emphasizing the development of local research capability.

5. Assist in financing development of nonprofit institutions in LDCs and links through which technical assistance could be provided.

Improve Organization and Administration of Assistance

1. Assist worthwhile programs as well as projects.

2. Staff AID with persons capable of being an effective conduit between government and business.

3. Continue and extend use of contractors to implement AID projects.

4. Formulate proposals to create one or more organizations to coordinate public and private technical assistance (e.g., a government corporation).

MINER REPORT (April 1967)

REPORT OF THE ACTION COMMITTEE ON TRADE AND INVESTMENT IN DEVELOPING COUNTRIES

Membership--Twenty-four members primarily from business and finance.

Charge--Action committee established by National Export Expansion Council of the Department of Commerce in April 1966 to seek ways that U.S. aid programs could make a greater contribution to U.S. export development objectives.

General Conclusions

1. U.S. business activity in developing countries is substantial and growing. Nevertheless, this activity is spotty in different areas and for different commodities.

2. A substantial increase in the level of activity by U.S. firms in LDCs could provide important benefits to the firms involved, to the United States, and to the LDCs themselves.

3. In spite of substantial efforts of the U.S. business community, the U.S. Government, and LDC governments to expand business involvement, the current level of such efforts is unlikely to bring about an increase in U.S. business activity which the situation warrants.

4. Many businesses, because of perceptions of high risks and low returns in LDC markets, bureaucratic hurdles, lack of information, or an orientation toward traditional markets have avoided involvement in LDC markets.

5. U.S. Government programs, while in many cases highly valuable, are generally inadequate to offset prevailing disincentives and contain a number of discrepancies and gaps which limit their effectiveness, including:

   o inconsistent income tax provisions relating to business in LDCs;

   o wide variations in the applicability and availability of programs to help firms reduce risks;

   o variations in the availability of government capital for support of U.S. business;

   o significant gaps in government assisted market information, research, and development;

o lack of AID commitment to trade development at the programming and implementation level;

o limited efforts to assist LDCs expand their exports; and

o widely scattered, confusing, and contradicting responsibilities for development of economic policies relating to LDCs and support for U.S. business in the government.

6. Developing countries themselves have the most significant influence on business activity and can do much to promote business by providing a favorable investment climate through appropriate policies.

Recommendations

Increase Direct Investment

1. LDC governments should improve investment climate by reviewing their policies and developing a program to minimize barriers and maximize incentives to private investment.

2. U.S. Government should help initiate investment and trade by providing preliminary business information surveys along broader lines.

3. United States should help minimize risks of trade and investment by:

o making government guaranties more widely and simply available;

o exploring the possibility of adjusting guaranty premiums according to the locale and nature of risks; and

o considering using banks or other private facilities as agents for guaranties.

4. United States should increase tax incentives for U.S. investment in and exports to LDCs by:

o establishing a top-level interdepartmental government task force to work out with business representatives a program of tax inducements for exports to and investments in LDCs; and

o re-examining current tax regulations and IRS audit practices to remove disincentives to LDC operations such as uncertainties about acceptable pricing policies because of vague regulations, and complex and ambiguous provisions in the 1962 Revenue Act.

5. The Department of Commerce's Export Expansion Program should give more balanced attention to investment as well as exports.

6. U.S. firms should increase their efforts to invest in LDCs, including:

   o reassessing planning efforts to ensure that they are giving adequate weight to the future profit potential in LDCs;

   o informing themselves of U.S. Government services to firms in LDCs, and making effective use of these services;

   o making increased efforts to improve LDCs' understanding of modern private enterprise and its contributions to development;

   o being flexible in approach to business in LDCs, such as by encouraging local stock ownership, joint ventures, or franchise arrangements with local businessmen; and

   o expanding the efforts of export promotion councils to pay more balanced attention to both investment and exports.

7. U.S. firms should actively support private programs designed to strengthen local free enterprise in LDCs.

Increase Flow of Finance Capital

1. Broaden U.S. loan assistance by:

   o permitting U.S. Government loans for LDC operations to be more simply and generally available to credit-worthy U.S. firms;

   o exploring the possibility of issuing most loans through U.S. commercial banks and their overseas branches and subsidiaries;

   o creating a "National Interest Fund" to provide financing in cases where the national interest is involved, but where financing is not available through AID in the Export-Import Bank; and

   o allowing more flexibility in loan terms to desirable business activities which cannot otherwise be financed.

2. U.S. businesspersons should participate actively in development of aid policies and programs which help promote economic growth and business opportunities in LDCs.

Expand Private Sector Role in Provision of Human Resources

1. AID should seek to have as many private U.S. consulting, architectural, engineering, service, systems, and operating firms as possible participate in its technical assistance activities.

2. U.S. Government should "top off" salaries LDCs pay U.S. advisors and technicians and fees paid to U.S. consulting, engineering, and architectural firms to make these services competitive with those of other industrialized nations.

3. U.S. firms should provide training facilities through their local affiliates and support the development of adequate technical and business educational facilities in LDCs.

Expand Trade with LDCS

1. LDCs should promote their trade by moving as rapidly as possible toward the development of regional free trade arrangements with their neighbors.

2. U.S. should help LDCs expand their exports by:

   o reducing tariffs on products of particular importance to LDCs and encouraging other industrialized countries to do the same;

   o expanding AID programs designed to help LDCs expand exports; and

   o examining all legislation, regulations, and restrictions which limit the ability of LDCs to export to the U.S. and adjusting them to encourage such exports.

3. AID should increase its efforts to help LDCs increase their earnings from tourism.

4. U.S. should promote U.S. exports to LDCs by:

   o increasing AID attention to long-term U.S. export potential in developing its programs, including encouraging AID missions to discuss export development with U.S. businesspersons on a regular basis;

   o expanding programs--through AID, Export-Import Bank, or other means--to assure postinvestment foreign exchange availability to U.S. firms to enable import of necessary U.S. goods;

   o permitting loans of U.S.-owned local currency to local businesspersons to help finance the import of any U.S. goods on the same basis that they are used for imports of U.S. agricultural products;

- supplementing trade promotion programs with assistance to U.S. firms in providing training for local personnel; and

- providing cost-sharing for LDC export market surveys and extending cost-share arrangements available for market research related to agricultural exports.

5. U.S. firms should increase their efforts to trade with LDCs, including:

   - giving adequate attention to LDC markets in light of future profit potential;

   - developing products and approaches designed to fit the special needs of LDCs; and

   - expanding export expansion council programs to disseminate information on opportunities for and methods of doing business in LDCs.

6. U.S. businesspersons should actively participate in the development of policies to promote trade with LDCs such as tariff reductions.

Improve Organization and Administration of Assistance

1. Increase coordination of U.S. Government aid, trade, taxation, balance of payments, investment, and related policies at the highest levels of government.

2. Unify the various AID private enterprise support programs.

3. Enlarge AID full-time staff concerned with U.S. export development.

4. Increase the number and improve recruitment of commercial officers in U.S. embassies and consulates in LDCs.

5. Streamline and automate economic and business information services provided by the Foreign Service, Departments of Commmerce and State, and other agencies wherever possible.

PETERSON REPORT (March 1970)

U.S. FOREIGN ASSISTANCE IN THE 1970's: A NEW APPROACH

Presidential Task Force on International Development

Membership--Sixteen members from banking, business, agricultural research, agribusiness, academia, church, and law.

Charge-- Established in September 1969 by President Nixon to provide comprehensive recommendations concerning the role of the United States in assistance to less developed countries in the 1970s.

General Conclusions

1. The United States has a profound national interest in cooperating with the efforts of LDCs to achieve economic, political, and social development.

2. U.S. assistance to deserving countries should be steady and adequate, removed from short-term political and foreign policy considerations.

3. The United States should help make development an international effort, oriented toward LDC autonomy and making greater use of international lending agencies.

4. The United States should seek to expand the involvement of the private sector in LDCs, while contributing to popular participation and wide distribution of the benefits of development.

Recommendations

The Task Force recommended "a new approach" to foreign assistance involving major organizational changes in the operation of security, welfare, and development assistance.

Improve Organization and Administration of Assistance

Security Assistance

o Security assistance programs should be in one piece of legislation separate from development assistance.

o The Department of State should be responsible for implementing all security assistance programs except military grants and credit sales.

Welfare and Emergency Assistance

o all programs should be brought into one office in the Department of State, which would coordinate with private organizations through the advisory Committee on Voluntary Foreign Aid.

International Development Assistance

The present aid structure should be replaced by a new framework consisting of

- a U.S. International Development Bank which would

  --be an independent government corporation,
  --be under the broad foreign policy guidance of the Secretary of State,
  --include the Secretary of State and Secretary of Treasury on its Board,
  --be appropriated $2 billion for initial capitalization and authorized to borrow $2 billion from the public,
  --play a supporting role in financing selected development programs worked out by LDCs, international lenders, and private enterprise;

- a U.S. International Development Institute which would

  --operate similar to a private foundation,
  --include the Secretary of State on its Board,
  --be appropriated $1 billion for the life of the Institute,
  --concentrate on research, training, population problems, and social and civic development,
  --work largely through private organizations;

- the Overseas Private Investment Corporation as previously authorized by Congress to facilitate the participation of U.S. private capital and business skills in international development; and

- a U.S. International Development Council which would

  --assure greater emphasis on international development in U.S. trade, investment, financial, agricultural, and export promotion policies,
  --assure that assistance policies are directed toward long-term development purposes and effectively coordinated with international organizations.

Within this new framework, the task force recommended actions in several areas to improve development assistance.

Increase Direct Investment

1. Help investors minimize risk by:

   - promoting a World Bank proposal for an international investment insurance program; and

   - making greater use of U.S. guaranty programs to encourage international joint ventures.

2. <u>Encourage investment</u> by:

   - eliminating U.S. restraints on U.S. direct investment in LDCs;
   - considering use of U.S. business tax policy to facilitate investment; and
   - encouraging other governments and private firms to support regional private investment companies.

<u>Increase Flow of Finance Capital</u>

1. <u>Increase assistance to financial institutions</u> by:

   - providing greater support to local development banks; and
   - using local currency from agricultural credit sales to augment Bank programs.

2. <u>Reduce procurement restrictions on assistance</u> by:

   - seeking multilateral agreement to untie development lending from procurement in donor country;
   - permitting procurement from all developing countries of goods and services financed by U.S. loans; and
   - removing procurement restriction on U.S. investment guaranty program.

3. <u>Expand scope and utility of assistance</u> by:

   - providing loans to cover technical services as well as capital;
   - providing a range of lending facilities with varied terms, adjusted to individual country circumstances; and
   - considering degree to which assistance promotes local private enterprise and contributes to broad distribution of benefits and social development.

4. <u>Contribute more actively to evolution of capital and credit markets</u> in LDCs.

5. <u>Avoid debt crises</u> by:

   - encouraging the World Bank and International Monetary Fund to develop long-term strategies for recognizing and reaching early agreements for response to debt payment problems; and o improving debt terms that LDCs face.

6. Help countries become independent of concessional assistance by providing guaranty of foreign official borrowing on international capital markets.

Improve Human Resource Assistance

1. Increase share of work done through private channels.

2. Encourage greater involvement of business and professional organizations in exchanging experience with their counterparts in LDCs.

3. Don't terminate technical assistance when concessionary development loans end.

4. Continue technical support for self help community projects.

Expand Role of International Organizations

1. Give international organizations leadership role in working out programs and performance standards with LDCs.

2. Expand assistance channeled through international organizations, including:

   o increasing paid in capital of International Finance Corporation fourfold;

   o doubling U.S. contributions to the International Development Association and the Inter-American Development Bank; and

   o providing U.S. support to the African Development Bank.

3. Give high-level attention in interational arena to the problem of establishing an effective coordinated international system of assistance.

Improve Trade Relations with LDCs

1. Provide LDCs freer access to developed country import markets by:

   o continuing U.S. leadership in working to reduce tariffs and other trade restrictions;

   o supporting an international agreement extending temporary nondiscriminatory tariff preferences to LDCs without limits; and o removing quotas or allowing larger quotas on imports of products important to LDCs such as sugar, textiles, and meat.

2. Continue U.S. support for the development of regional markets among LDCs.

Address Population Problem

1. Give high priority to programs addressing the problem.

2. Propose a U.N.-World Bank study of needs and potentialities in this area.

WILLIAMS REPORT (July 1971)

UNITED STATES INTERNATIONAL ECONOMIC POLICY
IN AN INTERDEPENDENT WORLD

Commission on International Trade and Investment Policy

Membership--27 members from business, agribusiness, academia, farming, and labor.

Charge-- Established in May 1970 by President Nixon to examine the principal problems in U.S. trade and foreign investment, and to produce recommendations designed to meet the challenges of the changing world in the 1970s.

General Conclusions

1. Inflation, balance of payments deficits, and unemployment in the face of increased competition abroad have contributed to a crisis of confidence in the benefits of trade and other foreign economic relations in the U.S., evidenced by increasing calls for protectionism and frustration with U.S. policymaking.

2. At the core of the difficulty is the failure of government policies and international arrangements to keep abreast of the high degree of international economic integration achieved since World War II.

3. New policies in the internatonal and domestic setting are needed to facilitate adjustment to global economic changes while preserving the benefits of an integrated world economy.

Recommendations

The United States should pursue new domestic and international policies to enhance world economic welfare and facilitate adjustment to change.

Adopt Domestic Measures to Improve U.S. Economy and Balance of Trade

1. Reduce unemployment and price instability by adopting measures to control cost push inflation in addition to the use of monetary and fiscal policy, such as measures to:

 o control wage and price increases;

 o increase productivity; and

 o improve structure and functioning of labor market.

2. Improve U.S. export performance by:

   o improving technological capability through tax incentives, more flexible policy on mergers, regional development policies, and measures to remove structural impediments to mobility and productivity of U.S. labor and capital;

   o changing restrictive policies in such areas as antitrust law, transportation, and East-West trade;

   o promoting exports through increased financing of Export-Import Bank, liberalized lending programs, and greater effort to make exporters aware of Ex-Im Bank services; and

   o concentrating Department of Commerce and Department of Agriculture export promotion efforts on products with the greatest potential.

3. Ease adjustment to competition by:

   o increasing adjustment assistance to labor, especially for training, relocation, and health and pension benefits;

   o providing some adjustment assistance to small firms to aid in modernization and conversion of product lines; and

   o providing protection in special cases through temporary tariffs or orderly marketing arrangements.

Negotiate with Major Trading Partners on Several Issues

1. Reduce immediate balance of payments problem through

   o better coordination of monetary policies;

   o realignment of exchange rates;

   o more equitable sharing of defense costs; and

   o removal of import quotas and capital export restrictions.

2. Reform international monetary system to enhance currency convertibility and exchange rate responsiveness.

3. Eliminate protectionist policies such as:

   o the European Common Agricultural Policy;

   o preferential trade arrangements;

   o tariffs and quotas; and

   o export subsidies.

4. Reduce nontariff distortions such as:

   o tax credits and exemptions; and

   o different environmental, health, and safety standards.

5. Reduce artificial incentives and impediments to foreign investment guided by:

   o principles of freedom of entry and acquisition, remittance of earnings, and avoidance of double taxation; and

   o efforts to harmonize antitrust policies.

Improve Trade and Investment Relations with Developing Countries

1. Expand U.S. direct investment by:

   o improving investment climate in LDCs by adopting treaties on investment, opposing LDC expropriation of capital and ownership restrictions, and urging LDCs to accept international arbitration of investment disputes; and

   o helping to reduce risks by continuing insurance and guaranties, and promoting the establishment of multilateral insurance supported by LDCs as well.

2. Provide LDCs freer access to developed country markets by providing tariff preferences to LDCs.

3. Pursue commodity agreements to stabilize prices for potential commodities.

Expand Trade with Communist Countries

1. Attempt to expand trade while considering strategic implications.

2. Give President authority to remove tariff discrimination against Communist countries.

FOWLER-McCRACKEN COMMISSION REPORT (Fall 1982)

GOVERNMENT-BUSINESS COOPERATION IN THE DEVELOPING WORLD

Fowler-McCracken Commission on Improving Government-Business cooperation in the Conduct of U.S. International Economic Policy

Policy Committee on Government-Business Cooperation in the Developing World

Membership--Fifty-eight members from high levels of government, international organizations, and business, including the Administrator of AID, the Secretary of Agriculture, and several members of Congress.

General Conclusions

1. Many of the largest opportunities for international business exist in the Third World.

2. The private sector is the greatest agent for development available to LDCs.

3. The multinational corporation is the largest and most pragmatic "delivery system" for business development as well as the ideas which underlie the democratic process and the market economy system.

4. The climate for international business in LDCs has improved in the U.S. and many LDCs.

5. LDC government policies are perhaps the single most critical factor in attracting international trade and investment.

6. U.S. firms face heavy competition in LDC markets from companies in other developed nations.

Recommendations

The committee identified several actions which could be taken to improve government-business cooperation in promoting development.

Increase Direct Investment

1. Improve investment climate by:

   o reducing LDC government disincentives to foreign corporate operations in their countries, especially foreign ownership restrictions, fade out requirements, and limits on royalities and repatriated earnings;

- reducing U.S. government disincentives to U.S. corporate operations overseas such as the Foreign Corrupt Practices Act;

- establishing high-level LDC government mechanisms to give investors a method of "short circuiting" excessive bureaucracy; and

- expanding LDC government guarantees against risks of nationalization, changes in policies, or other instability.

2. Attract more U.S. firms--particularly small and medium-size ones--to invest by;

   - improving mechanisms to inform U.S. firms of business opportunities and market conditions in LDCs, including U.S. Government, World bank, and private sector mechanisms;

   - expanding use of "opportunity fairs" throughout the U.S. as a forum through which LDCs can explain their needs, make known their opportunities, and provide information about their markets to U.S. businesses;

   - utilizing bilateral working committees of U.S. and LDC government and business officials to identify opportunities in particular LDCs;

   - establishing bilateral investment treaties to support and encourage investment in particular LDCs; and

   - providing "one-stop service" to potential investors and exporters requiring information about the various government programs providing assistance.

3. Help initiate investment by expanding funding of preliminary feasibility and market studies of developing countries and follow-up investment assistance to U.S. firms.

Increase Flow of Finance Capital

Expand U.S. official support for loans for projects involving LDCs.

Expand Private Sector Role in Provision of Human Services

1. Increase U.S. efforts to promote international trade in services.

2. Provide a more favorable environment for the service sector in LDCs, including eliminating restrictions on the ability to repatriate income.

Expand Trade with LDCs

1. Set a goal in the United States of expanding international trade as a national economic priority of greatest importance.

2. Continue to work for reduced barriers to trade and increased dialogue between developed and developing countries through the General Agreement on Tariffs and Trade.

3. Inform the public and businesses of the importance of trade and the opportunities available through:

   o educational programs directed toward business schools and the general public emphasizing the importance of international trade to the U.S. and the need to understand the needs and goals of the Third World;

   o a national campaign to inform and involve small and medium-size companies in exporting to LDCs; and

   o greater publicity on U.S. embassy services in support of American exports and available to American firms overseas.

4. Increase efforts to promote trade, including:

   o expansion of Export-Import Bank loans and improvement of loan terms;

   o a stronger role for Department of Commerce country desk offices in providing market information and assistance to U.S. firms at home;

   o increased activities of U.S. commercial attaches in U.S. export development; and

   o greater support for the U.S. and foreign commercial service, from both public and private sectors.

5. Reduce U.S. Government disincentives to expanding trade by:

   o avoiding export controls;

   o investigating the impact on trade and investments of extraterritorial application of U.S. laws such as antitrust laws and the Foreign Corrupt Practices Act; and

   o requiring an "export impact evaluation" on new regulations (some Committee members felt this would be counterproductive).

Promote Development of Indigenous LDC Free Enterprise

1. Target LDC government funding for development of domestic infrastructure.

2. Promote investment of indigenous LDC funds within their countries.

II.

PRIVATE ENTERPRISE

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4.

AID PRIVATE SECTOR INITIATIVES: PAST, PRESENT, AND LESSONS LEARNED

By Deborah Orsini

AGENCY FOR INTERNATIONAL DEVELOPMENT PRIVATE SECTOR INITIATIVES: PAST, PRESENT, AND LESSONS LEARNED

EXECUTIVE SUMMARY

The purpose of this paper is to evaluate past and present private sector programs and lessons learned from the nearly 40 years of U.S. foreign assistance. This paper is intended to serve as background material for the development of a blueprint for future private sector program recommendations.

Ten major programs are described and evaluated in this paper: industrial development (under the Development Loan Fund (DLF)); foreign exchange access and savings; policy dialogue; capital market development; foreign private investment promotion; export promotion and development; tourism; training; technology transfer; and small-scale enterprise development.

Each of the major implementation mechanisms for the above programs is also discussed and evaluated.

Current Bureau for Private Enterprise (PRE) policy and programs are discussed and a summary evaluation of their efforts to date is provided.

The paper concludes that the two major programs which achieved the greatest degree of success were the technology transfer program and the foreign private investment promotion program. The former, via joint venture promotion and agribusiness, private and voluntary organizations, and management technology transfer mechanisms, successfully performed over the years the function of enhancing productivity in less developed countries (LDCs), improving LDC product quality, and promoting LDC product competitiveness in the world market. The latter has assisted the development process through the provision of needed foreign exchange, for both credit and equity purposes. The most successful mechanisms in attracting U.S. private investment appeared to be the Cooley loan program (local currency lending to U.S. investors) and the housing guaranty program (involving U.S. Government guaranties for the entire amount of the private investment).

Two other programs also achieved considerable success: the capital market development program, primarily via intermediate credit institutions, and the training program.

Program areas that were much less successful include the direct loan program under the DLF and the policy dialogue program using program loans.

The paper generally concludes that two primary forms of assistance to LDCs exist: technical and capital, and that a knee-jerk approach to the use of either as the sole development assistance mechanism is dangerous.

While the need does exist for capital markets and institutions to support them, the key problem is a lack of know-how. Investments should only be made if the know-how is present or if it is provided concurrently with the investment. As concerns the smaller enterprises in developing countries, emphasis should be placed on assisting only those that present real growth potential.

The most successful private enterprise programs have involved direct ties to U.S. firms and businesspersons and have been demand-driven. Every opportunity should be taken to continue to engage the U.S. private sector in the development process.

Useful investment promotion tools have been guaranties and cofinancing arrangements, although the latter are still somewhat experimental within the Agency for International Development (AID) as regards private lenders. More efficient local institutions for attracting and transferring equity should be explored, including venture capital firms and investment banks.

Emphasis should be placed in all private sector programs on establishing self-sustaining (nonsubsidized) institutions.

AID requires a more centralized and self-critical management process to ensure emphasis on adequate programs rather than concentration on individual projects. A centralized management process should promote the replication of effective initiatives as well as the dissemination of information on successful programs and projects to AID staff, missions, and recipients.

AID currently does not have the systems, organization, or staff to implement the private enterprise initiative effectively.

INTRODUCTION

Over the nearly 40 years of U.S. foreign assistance, programs implemented have concentrated on four major areas. Initially, concentration on reconstruction assistance to war-damaged Western Europe under the Marshall Plan (1945 through approximately 1957); followed by a shift to development assistance to lesser developed countries (LDCs), involving major infrastructure and industrial projects (1957 under the DLF to approximately 1973); followed by emphasis on basic human needs from 1973 to 1980, when most AID (Agency for International Development) projects concentrated on assistance to the poor majority in the LDCs, with limited assistance to the local private sector. The current Administration has taken a renewed interest in private sector initiatives and established the Bureau for Private Enterprise (PRE) to spearhead its efforts.

Each of these areas of concentration in foreign assistance had its own goals and methods as concerns private sector programs. The purpose of this paper is to evaluate past and present private sector programs and the lessons learned to serve as background material for the development of recommendations on future programs.

The definition of private sector program used in the context of this paper is any program which directly assists a private sector enterprise, or which is designed primarily to support the local private sector, or which expressly targets private investment promotion. This excludes programs whose benefit to the private sector is only incidental.

It was initially the intention of this paper to conduct a thorough examination of all AID private sector projects in order to summarize successes and failures. This approach was not possible due to the difficulty of obtaining adequate data on the agency's history of projects. There is no centralized data base on pre-1974 AID projects. The AID automated data base contains project abstracts on only those projects initiated or still active as of October 1974. Data on pre-1974 projects can only be obtained by pulling documents from the central file or the various bureaus on a project-by-project basis.

There are gaps in even the post-1974 data base. Only 83 percent of the post-1974 projects are in the data base (4,000 of 4,800 total projects). Evaluation abstracts are available for only 38 percent of them. Most such abstracts are current rather than ex-post evaluations of actual project impact.

In light of these difficulties, this paper relies on an interpretive approach to program evaluation, based on available centralized documentation and discussions with persons knowledgeable of agency operations over the years.

CATALOGUE OF AID PRIVATE SECTOR PROGRAMS 1957-1980

Ten major programs directed at the private sector are discussed in an order which is generally chronological according to the period in which the programs became major areas of concentration. For each of the programs, the primary implementation mechanisms are also discussed.

Table 4.1 indicates the ten major program areas and the decades in which they were emphasized.

Industrial Development

The period during which AID concentrated its programs on major industrial development in LDCs extended from 1957 through the 1960s. The Marshall Plan concept of foreign aid had dominated American thinking for over a decade after World War II, but the scope of U.S. foreign aid gradually extended beyond the restoration of damaged, but highly developed economies of Western Europe to include the more difficult task of creating modern economies in newly developing nations.

The objectives of this new orientation to foreign aid, as set out in Section 6 of the Mutual Security Act of 1957, were:

> "to strengthen friendly foreign countries by encouraging the development of their economies through a competitive free enterprise system; to minimize or eliminate barriers to the flow of private investment capital and international trade; to facilitate the creation of a climiate favorable to the investment of private capital; and to assist, on a basis of self-help and mutual cooperation, the efforts of free peoples to develop their economic resources and to increase their productive capabilities."

To accomplish these objectives, the DLF was established as a government corporation in August 1957.

TABLE 4.1

AGENCY FOR INTERNATIONAL DEVELOPMENT
PRIVATE SECTOR PROGRAM AREAS AND PERIODS OF CONCENTRATION

PROGRAM	DECADE			
	1950s	1960s	1970s	1980s
INDUSTRIAL DEVELOPMENT (DLF and Productivity/Industrial Development Centers)	XX			
FOREIGN EXCHANGE ACCESS & SAVINGS (CIP, Program Loans, Cash Transfers, P.L. 480)*	X	XX	X	X
POLICY DIALOGUE (Program Loans)*	X	XX	X	X
CAPITAL MARKET DEVELOPMENT (ICIs, Securities Markets)	X	X	X	XX
PRIVATE INVESTMENT PROMOTION				
Cooley Loans	X	XX		
Investment Guaranties		XX	X**	X
Investment Centers/Groups		XX	X**	X
Investment Project Identification		XX	X**	XX
Cofinancing (private sector only)			X**	XX
EXPORT PROMOTION			X	XX
TOURISM		XX	X	
TRAINING	X	X	X	X
TECHNOLOGY TRANSFER	X	XX	X	X
SSE DEVELOPMENT	X	XX		X

X- Program active.
XX- Decade of most activity to date.

* Not solely private sector.

** LAC only.

Development Loan Fund (DLF). DLF was empowered to provide financing, through loans, credits, or guaranties, to economically, technically, and financially sound projects. No grants or direct purchases of equity securities were permitted. (One of DLF's functions was to facilitate the shift of some U.S. foreign aid from a grant basis to a loan basis.) DLF was also given the then unique authority to accept local currencies in repayment of its loans to avoid excessive increase in dollar debt burdens in recipient nations. (This repayment mode was deemed impractical over time, and the FAA of 1961 requires dollar repayments.) The DLF was also empowered to acquire and dispose of real, personal, or mixed property, including mortgages, bonds, debentures, liens, pledges, and other collateral.

Because DLF funds were no-year appropriations and because, by statute, DLF was exempt from having to return the funds to the U.S. Treasury, DLF authorities created a revolving fund along the lines of that proposed by PRE for its activities.

Although many of the DLF authorities are still available to AID by law, including the authority to acquire and dispose of certain debt and equity instruments and the authority to make direct loans, most of these authorities were no longer used once the emphasis of AID's foreign assistance program changed to basic human needs (BHN) in 1974.

From August 1957 to November 1961, at which time DLF was merged with the International Cooperation Agency (ICA) to form AID, 220 credits were approved by DLF in the amount of $2.2 billion and were used to construct facilities and productive enterprises in 50 LDCs.

The two primary instruments of the DLF for private sector programs were the direct loan and convertible debentures. DLF loans and convertible debentures for the direct benefit of the private sector totaled almost $716 million or about 34 percent of its total commitments. (The balance of the commitments were directed primarily toward major public infrastructure projects.)

The purpose of the convertible debenture mechanism was not to enable AID to become an equity participant, but to provide projects with a vehicle for expanding their equity base at a later date through the sale of the debentures to the private sector once the projects had shown some success. Under the DLF, nearly a dozen borrowers obtained DLF financing in exchange for debentures convertible into equity.

Table 4.2 shows the distribution of DLF loans by sector and purpose.

TABLE 4.2

DEVELOPMENT LOAN FUND: DISTRIBUTION OF LOANS BY SECTOR AND PURPOSE AS OF NOVEMBER 3, 1961

	Food and Agriculture	Transportation and Communications	Power and Multipurpose Projects	Industrial Development	Other General Development	Total
DOLLAR LOANS						
A. Loans to Private Sector						
1. Direct Loans to Private Sector	2,600,000 (1)	---	7,378,913 (4)	236,392,997 (35)	510,151 (2)	246,882,061 (42)
2. Intermediate Credit Institutions	32,000,000 (5)	---	---	134,736,000 (26)	53,000,000 (9)	219,736,000 (40)
3. Loans to Public Borrower w/Private Impact	---	55,000,000 (2)	---	188,350,000 (10)	6,028,000 ---	249,378,000 (12)
Subtotal, Private Sector	34,600,000 (6)	55,000,000 (2)	7,378,913 (4)	559,478,997 (71)	59,538,151 (11)	715,996,061 (94)
B. Loans to Public Sector	180,975,943 (8)	462,469,525 (65)	466,250,000 (31)	138,413,600 (11)	124,032,194 (11)	1,372,141,262 (126)
Total, Dollar Loans	215,575,943 (14)	517,469,525 (67)	473,628,913 (25)	697,892,597 (82)	183,570,344 (22)	2,088,137,323 (220)
LOCAL CURRENCY LOANS (in dollar equivalents)						
A. Loans to Intermediate Credit Institutions	---	---	---	---	1,000,000	1,000,000
B. Loans to Public Sector	---	1,079,801	---	---	---	1,079,801 (1)

DLF pioneered the use of intermediate credit institutions (ICIs) as on-lenders to small business. Loans were made to 24 development banks in 18 countries in the amount of $150 million. DLF also supported national systems of savings and loan institutions. It pioneered the concept of tied procurement in 1959, which was the first time U.S. procurement had been required as opposed to free world spending authorization.

DLF projects involved several major industrial enterprises, incuding a cotton textile mill in Ethiopia; a sawmill in Liberia; a textile mill in Sudan; a pulp factory in Tunisia; an automotive parts plant in Indonesia; cement, nylon, and chemical plants in Korea; pulp, cement and explosives plants in the Philippines; a cement plant and glass factory in Taiwan; a meat processing plant in Thailand; two sugar refineries in Bolivia; a sissal plantation in Haiti; a savings and loan in Peru; a housing project in Venezuela; two development banks in Israel; an electric power plant and a phosphate mine in Jordan; an aluminum plant in Lebanon; a steel mill in Turkey; a canning and freezing plant in Egypt; a textile mill in Syria; a thermal power plant in India; and a gas treatment plant and three loans to a major development bank in Pakistan. Loans were made at 5.75 percent to profit-making firms.

Despite the impressive inventory of projects, the results of the DLF direct loan program are generally considered mediocre, although few formal data exist on the success rate of the various loans. One of the more notable successes is the Korean Hyundai Construction Company, which received DLF assistance in 1959 and is now a thriving enterprise with sales in excess of $2 billion per year.

Two convertible debenture projects which were successful are the Sui Gas Company in Pakistan and an abattoir project in Thailand. (In both cases, DLF elected neither to convert its local currency debentures nor to sell them on the grounds that to do so would adversely affect the companies and the economies of the host countries. DLF felt that future dollar dividend payments would make a greater demand on the companies and the host country foreign exchange position than would servicing the loans.)

Some of the more notable failures include the Liberian-American sawmill project which failed primarily due to poor management. The Sudan American Textile Industries project also failed. The local management was inexperienced and the project became insolvent in two years. DLF resold the equipment to private interests in other countries. DLF had committed $10 million. It sold its interests to the Arabian Textile Company and wrote off $6 million.

Other failures included the two sugar refineries in Bolivia, in which both loans were defaulted. One ultimately was repaid after rescheduling, while the other was written off.

Generally, DLF failures are attributed to the lack of experience of the investors on whose judgment DLF relied and to the degree of capitalization of the project. As a program mechanism, the DLF direct loans appear to have been extremely time-consuming from the standpoint of the limited staff available and did little to provide any institutional benefits to the countries in which the projects were implemented. The LAC, Near East, and Asia bureaus all noted that their comparative experience with intermediate credit institutions has been more favorable from the standpoint of loan monitoring and institutional development. However, one of the primary goals of DLF was to transfer capital resources, which it did accomplish.

Productivity and Industrial Development Centers. During the DLF period, a certain number of Productivity Centers and Industrial Development Centers were also developed, including one in Pakistan and five in Latin America and the Caribbean (LAC) (Chile, Guatemala, Panama, Jamaica, and Mexico). The project in Panama appears to have been the most comprehensive and successful, including economic investigation and promotion, technical consultation, management seminars in operational practices, training in local plants, information dissemination on technical matters, and participant training in the United States and other countries.

The results of these initiatives were mixed, with a number of 'indifferent results' indicated. The centers could not exist without other government programs, a very active promotional program, and close ties to the business community. Start-up subsidies were essential and long-term commitments were often necessary to ensure institutionalization.

Foreign Exchange Access or Savings

Since 1952, AID has made available over $7.7 billion in special loans to LDCs to permit them to overcome foreign exchange constraints. (This amount includes $1.8 billion in LAC, $5.4 billion in the Near East, $295 million in Africa and $222 million in Asia.) Three instruments are involved: program loans, commodity import programs (CIPs), and cash transfers. (However, since the 1970s, only a small portion of these funds can be classified as "private sector assistance.")

The program loan provides dollar-denominated loans to LDCs which are normally conditioned, i.e., certain policy modifications are expected in exchange for the loan. (Program loans as an instrument for influencing public policy will be dealt with in Section II.D.)

The commodity import program provides financing to meet the foreign exchange cost of imported goods and services. (Since 1981, they are increasingly being used to support the private sector.)

Cash transfers are effected in the context of the Economic Support Fund to assist with balance of payments or economic development problems in countries where the United States has special security or foreign policy objectives.

Leading recipients of these types of assistance include Brazil, Chile, Colombia, Dominican Republic, India, Pakistan, Turkey, Tunisia, Egypt, Korea, Israel, Nigeria, Zaire, and Zambia.

Most of these programs made foreign exchange available for imports from the United States, over and beyond an agreed-upon base level. Generally, targeting of use of the funds for specific import requirements was not done, especially when private sector groups were involved.

Difficulties in negotiating these loans, the lack of a directed impact, and a scarcity of funds, particularly in LAC where Alliance for Progress funds had been used in the 1960s, caused this type of program to be less widely used in the 1970s. However, in Latin America and the Caribbean and Egypt, they are beginning to be used again on a more selective basis with a focus on use of the imports for private sector use. (The ultimate use of these funds, however, is regulated by the host government and cannot be considered responsive to free market forces.)

A mechanism for saving foreign exchange is the P.L. 480 program, which permits payment in local currency for imported U.S. agricultural commodities. Although this program itself does not directly benefit the private sector, local currency funds thus generated have been used generally for infrastructure, education, intermediate credit, and industry. Certain of these funds are now being used for private sector support. (In El Salvador, local currency generations have recently been used for an industrial working capital fund.)

Policy Dialogue

Finding effective means of influencing public policy in areas related to private sector interests is a difficult task. Past experience has involved two primary mechanisms: formal conditioned program loans and informal continuing policy dialogue. A few scattered projects dealt with policy formulation, but their impact was far more limited than that intended by the two primary mechanisms.

A 1970 study of the use of program loans to influence public policy concludes that over the period 1962 and 1968, program loans did effectively influence policy. (Countries studied included those which consistently received program loans over those seven years: Brazil, Chile, Colombia, India, Pakistan, Tunisia, and Turkey.) The two primary mechanisms were clearly evidenced in the sample population: AID missions in the LAC countries and Korea used formal conditioning with regular performance reviewed and tranche releases of the loans, whereas those in the Near East countries adopted the informal approach. (Tunisia shifted to a more formal approach after two years.)

In spite of definite policy modifications achieved, the results obtained, when evaluated against loan conditions or mission goals, were considered moderately encouraging at best. (Only in Korea were the results considered impressive.)

The report concluded that the program loan should be maintained as a major element of the assistance package in countries where the United States wants to influence overall policies and will supply the human and material resources necessary to do so and where the host government gives hope of success. It was recommended that policy conditions be kept few in number and be clearly defined; that the program loan approach to policy dialogue not become routinized; and that if policy influence is working well and progress is being made, more emphasis be placed on increasing self-help and diminishing aid.

The impact of individual projects geared to influence policy is generally more limited because of their more restricted scope and the more limited amount of funds involved. The two LAC projects described below serve as examples of successful public policy projects.

An employment policy project in the Dominican Republic was undertaken in 1979 to organize an Employment Analysis and Planning Unit whose objective was to formulate recommendations on how to stimulate additional employment in the private sector. Recommendations were made relative to using more labor-intensive technology, on fostering small enterprises, and on improving rural farm and nonfarm employment opportunities. The second project involved a grant in 1978 to the Jamaican National Planning Agency to establish an integrated manpower development and utilization system responsive to labor market needs. LAC concluded that these projects were useful in sensitizing public officials to the need for incentives and disincentives in improving output and employment.

Capital Market Development

Capital market development is essential to the private sector to permit it to access the debt and equity capital necessary for its start-up and expansion activities. The objective of capital market development programs is to mobilize savings which can be used for productive investments. AID has been very active in the financing and institution building of intermediate credit institutions (ICIs) and, to a much lesser degree, in the development of local securities markets.

Intermediate Credit Institutions (ICIs). The period of greatest development activity involving ICIs occurred during the 1960s. An evaluative study of ICI investments conducted in 1969 indicated that from 1958 to 1968, AID had granted 61 dollar loans to 45 ICIs in 34 countries with an average loan amount of $5.2 million. Seventy-five percent of these loans were made to the LAC and Near East South Asia (NESA) bureaus, 80 percent to banks in more developed financial settings, and 67 percent to public ICIs for purposes other than seed capital. (The trend, however, was changing by 1969 from financing provided to public ICIs in more financially developed countries to financing provided for seed capital in private ICIs in less developed financial settings.)

The major objectives of the ICI development assistance undertaken by AID were: (1) to develop institutional capability for appraisal banking; (2) to extend medium- and long-term credit and to provide equity financing where it did not exist in sufficient quantities; (3) to mobilize domestic resources by stimulating complementary investment; (4) to direct investment in high-priority development areas, such as agribusiness to finance start-up or expansion of productive facilities; (5) to broaden access to the formal credit system and extend outreach; (6) to foster self-sustaining and financially independent institutions capable of continuing their operations once development assistance was withdrawn.

The study concluded that the great majority of AID's development assistance to ICIs has been successful. Most institutions created with AID seed money are now self-sufficient and provide needed financing and services to new and expanding enterprises, some of which would be unable to obtain credit in the commercial market.

In the area of mobilization of resources, it was found that most ICIs provide between one-third and two-fifths of the total investment required. The remainder is mobilized externally.

The study concluded that the loan application procedures of many ICIs serve to improve the financial and business practices of firms applying for assistance. In addition, certain of the ICIs offer technical assistance to their subborrowers, although the general conclusion is that there is always a need for more.

Additionally, the allocation of scarce AID resources to loan review has not been necessary, since the ICIs perform this function.

There are, however, certain problems with ICI programs. ICI operations may be ineffective due to distortions in the price structure in markets in which they operate. Government policies of protectionism, overvalued currency, or lack of investment incentives, among other things, can distort the allocation of the scarce medium- and long-term resources available to ICIs.

There is a tendency for ICI subloans to be directed to larger or better established enterprises. Small-scale enterprises (SSEs) may receive little attention, due primarily to the higher risk, the higher relative cost of loan administration, and the need for more extensive technical assistance (TA) to these enterprises. (A solution adopted for this latter problem was the establishment, primarily in the late 1960s and 1970s, of specialized small and medium-scale enterprise (SMSE) promotion offices to assist entrepreneurs with loan applications and to provide ongoing management training. Section II.K discusses the small-scale enterprise development programs, both industrial and agricultural, in more detail.)

Inadequate appraisal banking capabilities were also identified as a problem in certain instances, resulting in excessive reliance on high collateral or very short loans to compensate for the risk factors involved. This problem was generally solved by the provision of additional technical assistance to the ICI staff.

The specific instances of successful projects are numerous. The Industrial Intermediate Credit and Investment Corporation of India, which received dollar loans from AID in the early 1960s, is frequently quoted as a prime example. The AID loan effectively increased the foreign exchange available for relending to the private sector and provided an incentive for the purchase of American equipment (subloans were made to private sector companies which intended to use U.S. goods in their projects). A considerable amount of supervision of the relending operation was provided by the AID mission in New Delhi. The project also served as a source of information to the mission on the operations and problems encountered by private companies. This information was useful in the policy dialogue being carried on between AID and the Indian government, relative to investment, regulatory, and fiscal policies for the private sector.

In Korea in the 1960s, capital and technical assistance were provided to two public banks, the Medium Industry Bank and the Korea Development Bank, and to one new private bank, the Korea Development Finance Corporation. These three banks were considered highly successful from the standpoint of subprojects financed, increased availability of investment credit for the private sector, and the upgrading of the banks' appraisal banking capability.

Another very successful project involved the Philippines Private Development Corporation (PPDC), to which AID furnished $10 million in resources which were subordinated to both debt and equity as a means of attracting additional equity to the project. (AID in fact held quasi-equity in PPDC.) The PPDC has become an energetic and important force in private sector support. The subordinated position of AID encouraged several U.S. and foreign commercial banks to take equity holdings in the PPDC.

Latin America and the Caribbean has been very active in ICI assistance, providing over $1 billion in development loan financing to 91 ICIs since 1961. In addition to assistance to development banks, LAC also supported credit unions and savings and loans. Savings mobilized by credit unions grew in LAC countries from $78 million in 1962 to $600 million in 1979. Membership grew during the same period from 300,000 to 2,500,000, while the number of credit unions almost tripled. Savings and loan association figures are similar to those for credit unions.

Latin America and the Caribbean helped establish the Confederacion Latin America de Cooperativas de Ahorro y Credito (COLAC), a private, regional confederation of credit unions, and provided considerable support to Banco Interamericano de Ahorro y Prestamo (BIAPE), a private interamerican savings and loan bank. Both institutions are successful.

In Africa, major development loans to ICIs were made to the Ivory Coast Development Bank, the Credito Somalo, and the West African Development Bank, all of which were considered generally successful.

As concerns project failures, it is difficult to identify any project as a total failure since credit is supplied to a large number of subborrowers in all instances and there are individual successes among that population. However, it would appear that the loan to the Entente Fund's African Enterprises Program was less a success than most other ICI loans. Technical assistance was not readily available to the subborrowers since the TA office for the fund was separate from the development banks (the Entente Fund was the recipient of the AID loan and then on-lent funds to national development banks in the five Entente countries). The loan was also used to fund too many projects in the most developed of the five countries (Ivory Coast), rather than being spread evenly among all countries. Larger firms were generally favored over smaller ones and insider contacts were used to obtain funds.

A development bank project in Afghanistan failed in the early 1970s due primarily to the lack of a supportive political climate for an institution serving small private industrial companies. The lack of trained staff for subproject selection was also identified as a problem.

On the whole, evaluations of ICI projects indicate acceptable results from the standpoint of resources transferred and jobs created.

Securities markets. The development of securities markets in LDCs is a difficult task because it requires a fairly sophisticated financial system and acceptance locally of the concept of selling equity to "outsiders." Data are available on two projects only: a failed attempt to provide technical assistance to the Karachi stock exchange in the 1970s and successful technical assistance from the New York Stock Exchange to Korea to revitalize the Korean stock exchange operations. The lack of projects in this area as well as the conclusion from ICI evaluations that attempts to sell down equity purchased by the ICIs have failed are indicative of the limited prospects of securities markets development in most LDCs at their current stage of development.

Foreign Private Investment Promotion

Successful foreign private investment promotion began in the late 1950s with the Cooley loan program. (DLF, on the whole, was not successful in attracting large private investments.) Foreign private investment was pursued most actively through the 1960s and again since 1980. The types of instruments used in this initiative include Cooley loans, investment guaranties, investment centers and groups, project identification, and cofinancing arrangements.

Cooley loans. The Cooley loan program was established by a 1957 amendment to the 1954 Agricultural Trade Development and Assistance Act, sponsored by Representative Harold Cooley of North Carolina to "promote balanced economic development and trade among nations" by permitting local currency loans to U.S. firms or their affiliates for business development and trade expansion. The loans were to be used to establish facilities to aid in the use, distribution, or marketing of U.S. agricultural products. Funds for the Cooley program derived from local currency proceeds from the sale of U.S. agricultural products under P.L. 480. Table 4.3 shows the breakdown of Cooley loans according to geographic bureau.

TABLE 4.3

BREAKDOWN OF COOLEY LOANS BY BUREAU

BUREAU	NUMBER	AMOUNT
AFRICA	4	$4,755,000
ASIA	196	$279,639,000
LATIN AMERICA AND THE CARIBBEAN	83	$25,496,000
NEAR EAST	144	$120,600,000
TOTAL:	227	$430,490,000

SAMPLE: LATIN AMERICA AND THE CARIBBEAN BUREAU
COOLEY LOAN EXPERIENCE

COUNTRY	TYPES OF PROJECTS	YEAR OF AUTHORIZATION	AMOUNT LENT (Dollar Equivalent)
Bolivia	Cement plant	1965–1969	$1,494,000
Chile	Corn processing, radio plant, textiles, poultry, pharmaceuticals, liquid carbonic acid	1961–1967	$1,218,000
Colombia	Chemicals, animal feeds, aluminum, paperboard, pharmaceuticals, containers, starch, hotel, tires, razors ceramics, corn, poultry, sewing machine, pipe	1959–1968	$7,228,000
Ecuador	Electronics, carbon	1963	$ 867,000
Mexico	Retailing, textiles, warehousing, farm machinery, electronics, pharmaceuticals, paper, chemicals, air conditioning, apparel, balanced feeds	1958–1959	$7,175,000
Paraguay	Cattle ranch	1963–1964	$1,204,000
Peru	Retailing, footware, dairy, matling, poultry, jute, salt, lab, animal feeds	1959–1966	$2,979,000
Paraguay	Appliances, textiles, farm machinery, corn processing, tobacco, vegetable oils	1959–1963	$3,331,000
		TOTAL:	$25,496,000

Loan terms involved maturities set according to the nature of the project and the recipient's projected cash flow with grace allowed until the facilities became productive. Interest was set for each country based on the locally available rate from development lending institutions. (However, Cooley rates were usually lower than local rates for long-term financing.) Repayment was in local currency with no maintenance of value requirement. Greater priority was given to capital investment needs than to working capital requirements because of scarcity of resources for the former.

Complaints from U.S. firms included the unavailability of sufficient funds in certain markets (particularly Latin America and the Caribbean), delays in processing which occurred when missions had only limited staff, high interest rates, and few available working capital loans. From the standpoint of the local missions, the Cooley loan program required extensive staff time for application review and approval.

The development benefits derived included the creation of productive industries; export of U.S. private capital, management skills, and technology to countries where most U.S. firms would not have gone; and encouragement of private enterprise development.

The benefits to the United States included dollar reflows created from fees, royalties, dividends; expansion of U.S. capital goods and raw materials exports; and the political value of establishing good working relationships between U.S. investors and local businessmen.

The overall program evaluation indicates that the program was highly successful. Despite the fact that Cooley loans, unlike dollar loans, were often made without security or guaranty, the program's loan repayment record is good. Although the risks accepted under the program were high in comparison with commercial lending, the loss record is comparable to that experienced by U.S. commercial lenders in their international lending activities.

However, the Cooley loan program was subject to inherent constraints, the most significant being that funds could not be generated to respond to expressed needs. Countries with the largest supply of local currency were usually those in which the investment climate did not attract U.S. private investment, and vice versa. Therefore, the program as designed and implemented was not a generally applicable solution to the problem of providing local currency funding for private projects at reasonable rates.

Examples of successful Cooley loans include over 100 different loans made in India, Pakistan, and Turkey in the 1960s to joint ventures between U.S. firms and local, privately owned companies. The Korea Cooley loan program was also highly successful, involving three stages: initial projects for U.S. and Korean joint venture industrial plants; second-stage projects involving Korean firms using P.L. 480 products (bakeries and fats and oils projects); and third-stage projects involving U.S. branch banks in Korea which sublent the funds and provided portfolio administration in return for a fee (this latter stage was necessary due to the reduction in the Korean AID mission staff).

The Cooley loan program in Taiwan and the Philippines was also very successful, involving manufacturing, fisheries, and chemical projects.

In Latin America, Cooley loan borrowers included affiliates of such firms as Ralston Purina, Goodyear Tire, Gillette, Quaker Oats, Singer, General Telephone and Electronics, Sears Roebuck, Grace and Co., General Electric, Monsanto Chemical, John Deere, and International Harvester.

The primary example of an unsuccessful project is that of the Ejura Pioneer Farm, the largest farm in Ghana in 1969 when the loan was implemented. Two million dollars in local currency was made available to Ejura, which was 60 percent owned by U.S. interests (Republic Steel) and 40 percent owned by the government of Ghana. The project operated at a loss from inception, due to absentee management and excessive overhead costs. It also encountered several technical and marketing problems. The project was never able to meet its repayment schedule, although it did continue to operate since its produce was essential to the food supply for the poor in Ghana. Additional AID financing was provided in 1974 in an effort to recapitalize the project, but the effort was unsuccessful. The U.S. participants ultimately gave up their interest, and the government assumed control and the Cooley loan indebtedness. AID wrote off all of the capitalized and accrued interest.

Investment guaranties. During the 1960s, AID managed a number of incentive programs to encourage private U.S. investment in Asia, Africa, and LAC. Under the Specific Risk Guaranty Program, AID insured U.S. investors against specific risks involved in investing in LDCs, including repayment of principal, inconvertibility of earnings, and losses due to expropriation, war, or revolution. In the early 1960s, coverage in the amount of $500 million per year was provided. This authority was transferred to the Overseas Private Investment Corporation (OPIC) in 1971.

In the mid-1960s, the Extended Risk Guaranty Program was initiated, offering greater protection for investors than that provided by the Specific Risk program. Under this program, the investor was guaranteed against a certain percentage of loss of investment from any cause other than the investor's own misconduct or risks covered by normally available commercial insurance, such as fire, theft or flood. This authority was also transferred to OPIC in 1971.

One of the most publicized investment guaranties was the Calabrian project, which involved the storage and milling of maize in Thailand. An investment guaranty was provided to an American investor by AID in 1968. The investor created a Thai corporation and borrowed money from New York banks to finance the project. Repayment of the loans was guaranteed by AID. The investor's common stock was placed in escrow as security for the extension of the AID guaranty. The loans were defaulted. AID paid off the New York banks and assumed ownership of the investor's shares, making AID in effect the operator of a Thai corporation in competition with local businessmen. AID tried unsuccessfully to sell the company as a growing concern to several U.S. companies. AID was later sued by the investor who claimed that the default had been contrived by AID. AID submitted to the jurisdiction of the Thai courts, where its position eventually was upheld.

Both risk guaranty programs resulted in a total of $2.6 billion in investment guaranties outstanding by 1965. The programs apparently had a substantial impact on the rate of U.S. direct investment in LDCs during their lifetime, although it is not possible to determine the exact amount of additional direct investment due to the guaranties.

Since 1961, AID has managed the Housing Guaranty Program, which promotes basic shelter and related services and facilities for low-income people in LDCs by mobilizing U.S. private sector resources in the form of loans made to foreign governments or their agents. AID provides a full faith and credit U.S. Government guaranty of the loans made.

Although there have been a few problem cases, the Housing Guaranty Program is generally considered an outstanding success, with over $1 billion of guaranties outstanding and a default rate of less than 1 percent.

The AID evaluation of two housing guaranty programs in Panama (one for $3.5 million to build new low-income housing and the second for $15 million to upgrade existing slum projects) attests to both the effectiveness of the guaranty itself and the considerable improvement in quality of life for the beneficiaries. In one project, the living space available increased by 150 percent.

A final type of guaranty program is the Productive Credit Guaranty Program (PCGP). The goal of the PCGP is to increase opportunities for profitable investment by facilitating access of small entrepreneurs to the services of the formal credit system, via guaranteed loans. Programs have been initiated by the Latin America and the Caribbean Bureau in Bolivia, Costa Rica, Paraguay, and Nicaragua. As of the end of calendar year 1980, over $16 million in guaranties had been issued, with the vast majority going to Paraguay ($12.5 million). Although the number of loans extended under the PCGP has been impressive, a number of problems have arisen as regards operational and administrative issues. Results are considered mixed at best. The program has now been taken over by PRE.

It should be noted that in 1979, LAC commissioned a study by Peat, Marwick and Mitchell (PMM) entitled "Selection and Development of a Private Sector Financing Mechanism." The study was conducted to recommend an alternative financing instrument for facilitating private sector investment in projects, especially those in middle-income LAC countries. Two instruments were selected, one guaranteed and the other not. Both involved loans from private lenders (most probably large commercial banks) which were to be matched by a loan from AID.

The preferred instrument was a loan by a private lender to a LDC project with a full U.S. Government guaranty. Although new legislation would have been necessary to implement this instrument, it was felt that it would appeal to a broader market, would allow significant leverage of AID resources, would be available for use on a recurrent basis, and could be used for financing a full range of development programs in virtually all of the LAC countries.

Recognizing that the new legislation required might not be attainable, PMM also recommended a second instrument--an unguaranteed loan from private lenders to only the most credit-worthy of AID borrowers. PMM felt that the private lenders would require an automatic cross default clause from AID with respect to its matching loan, and a full personal guarantee, as well as 25 percent of the project capitalization from the project sponsors. Anticipating objections from OMB and Treasury, the previous Administrator did not take action on the recommendations.

<u>Investment centers and groups</u>. The purpose of investment centers and groups was to attract direct U.S. private sector investment in specific investment opportunities. AID was instrumental in establishing the India Investment Center in New York, assisting with a loan and technical assistance. That operation has since expanded its activities to include Europe. AID also provided technical assistance to investment centers for Korea, Taiwan, Thailand, and Indonesia.

An Investment Information Center is being organized for Egypt, to identify investment opportunities and priorities, develop data, publicize the investment opportunities, and facilitate the investment process for potential investors.

LAC has provided grant assistance to the Caribbean Association of Industry and Commerce, which provides investment promotion services to its members. Additional assistance is provided to local Chambers and Commerce and business associations to publicize investment opportunities.

A recent, well-known investment promotion initiative was Project ICONE, or the International Conference on New Enterprises, implemented in Manila in June 1979. Although AID did not initiate the project, it did participate in its funding, along with the U.S. private sector and the World Bank. The project concept was developed by the Enterprise Institute of Ohio, a nonprofit economic development corporation. The goal of the conference was to stimulate international cooperative efforts to establish SMSEs in LDCs to expand employment at a reasonable cost. In an evaluation conducted in 1981, the attendees interviewed strongly recommended continuing the concept, on the basis that it provided good information on coventures and served as excellent U.S. public relations and as a platform for advocating public policy advantageous to small business. The conference resulted in 19 business ventures by nine individuals, amounting to $27-$31 million in potential investments and between 750 to 1,150 jobs.

An example of a failed investment promotion initiative is the Inter-American Investment Development Center, a business clearinghouse, which was designed to stimulate U.S. private investment in LAC countries by screening and presenting potential investments to U.S. investors. The center was in New York, but the investment proposals were prepared in-country. An evaluation stated that the project concept oversimplified the problems of developing viable projects to meet U.S. standards and those of LAC entrepreneurs. The proposals were not well-prepared and the LAC staff were not sufficiently qualified. The evaluation emphasized that entrepreneurs need assistance in developing investment proposals and that, in fact, it is probably best to direct developed country firms interested in foreign investment to LDCs so that, with proper assistance, they can find their own local partners.

Investment project identification. AID has employed several mechanisms over the years to identify and develop projects, including pre-investment surveys, feasibility studies, and project identification units.

In the 1960s, the Investment Survey Program encouraged private U.S. investment in developing countries by sharing the costs of surveying potential investments overseas. In this program, AID paid 50 percent of the cost of the survey if the investment was not made. A 1966 evaluation stated: "experience to date suggests the program is justifying its cost: AID is obligated for nearly $500,000 or its share of 56 completed surveys in which the investment decision was negative compared with 19 affirmative decisions, which will bring up to $50 million in American private capital into less-developed countries."

The program usually involved in-country visits by U.S. businesspersons to survey the potential market, availability of raw materials, communications, labor, and applicable foreign government regulations. This program was eliminated from the AID scope of authorization in 1969, but similar programs are now under OPIC's authority.

During the 1960s the LAC Bureau authorized 23 feasibility study loans totalling $67.7 million, of which $51.5 million were expended. A study conducted in the early 1970s found that $12 of investment was made for every $1 of LAC Bureau funding for feasibility studies, although the report indicated that several large investment projects skewed this ratio upwards. The general feeling, however, regarding these loans is that many of them were slow-moving and produced voluminous reports which sat on the shelves of various LDC ministries. Although the studies identified needs, they remained academic exercises in the absence of private investor interest.

The Reimbursable Development Program and the PRE Feasibility Cost Sharing Program both appear to be far more cost-effective since they finance studies in response to existing demand, rather than for the purpose of building an inventory of bankable projects, as was the case with the 1960 LAC feasibility study program.

There are two examples of project identification units among recent projects. The first is the Caribbean Project Development Unit, jointly funded by AID, the International Finance Corporation, and the United Nations Industrial Development Organization. The unit is designed to identify projects in the Caribbean in the $500,000 to $5 million range. Although the unit is still in a start-up phase, it has identified several projects (one of which was selected for funding by PRE).

The second example is the Eastern Caribbean Development Program, involving project development advisors in several Eastern Caribbean LDCs to develop projects in the productive sector. The contractor is also required to find external investors at times, as well as markets and technology for specific projects.

Cofinancing. Cofinancing with private sector institutions is a relatively new mechanism for AID. The efforts undertaken most recently by PRE will be discussed under Section III of this report. Other than those initiatives, the only other recent cofinancing projects with private sector institutions have been implemented by LAC. (Some 16 others have been implemented with public sector institutions since 1961.)

The most frequently mentioned cofinancing project of the 1970s involved a LAC loan agreement with the Latin American Agribusiness Development Corporation (LAAD). AID had been instrumental in organizing LAAD in the early 1970s. LAAD has served as a private sector intermediary for identifying new small and medium-sized agribusiness projects and for introducing new technology to these same enterprises. The development impacts of the LAAD subprojects include employment generation, linkages to small agricultural producers, and expansion of nontraditional exports which generate foreign exchange.

In the most recent LAAD project, LAAD matched the $6 million AID loan with $6 million in private sector borrowings and supplied $7.3 million of their own resources.

Another example of cofinancing in AID's recent past involves a $10 million loan to BANEX, a private Costa Rican export bank, made in September 1981 to support a private sector alternative to state-owned banks. The loan will allow BANEX to provide export-oriented banking services, to make credit available to export producers, and to create a trading company to assist exporters in Costa Rica. The project envisions the possibility of cofinancing eventually from private sources, although the economic constraints are not favorable at this time. To provide for this possibility, however, the loan agreement makes provision for a cross default clause.

It is generally felt that the leverage obtained for AID funds from a cofinancing arrangement, as well as the assumption of the subloan administration and monitoring responsibilities by the cofinancing partner, make this mechanism an extremely attractive one in light of very limited AID human and financial resources. While there is some disagreement on the effectiveness of the LAAD program, particularly as concerns its level of equity participation, it has achieved a high degree of outreach to the local smallholders and a very satisfactory degree of leverage.

Export Promotion and Development

Many of the early industrialization projects tended to emphasize import substitution in areas such as the manufacture of steel, pulp, and automotive parts. While this economic policy could be justified as long as there was a relatively sizeable market for the product (either nationally or regionally) and as long as excessive price distortion or protectionism did not occur, this approach no longer enjoys the solid endorsement it once did. A more complete approach to market development, including both internal and external orientations, has proven the most viable solution. While the domestic market should not be ignored, export development has demonstrated good economic growth potential (e.g., Korea, Taiwan, Brazil) and serves to generate needed foreign exchange. Export promotion became increasingly frequent as of the mid-1970s.

A major effort was undertaken in India in the 1970s to assist local export promotion by establishing industry groups (including agricultural producers), organizing and financing trade group visits to the United States and Europe, and contracting for market studies. The goal of the program was twofold: (1) to influence the Indian government via the market studies and research effort to allow export industries to develop in the private sector rather than consider nationalization and (2) to promote the export marketing of future production. Although no specific evaluation of project impact was conducted, it is assumed that it had a direct bearing on the later expansion of Indian exports.

In Korea, AID funded a long-term advisor to assist the Korean Trade Promotion Office (KOTRA), an example of highly effective export promotion. In Taiwan, AID funded an advisor and participant training.

The one major PPC operational program geared to private sector activities is the World Trade Institute project which has been supported by AID since 1973 to expand its educational, training, and technical services for export development and trade promotion assistance to LDCs. The rationale for the program is that most LDCs need increased foreign exchange to finance growing imports and external debt, to create jobs, and to train local personnel in production and management practices. However, most LDCs do not have specialized institutions with trained manpower to assume responsibility for a comprehensive export promotion program (project identification, marketing, transportation, cooperation between government and business, etc.). Evaluation of this project indicates success, which can be measured by the increasing number of clients who are willing to pay for these services.

An export promotion program in LAC begun fairly recently involves the development of business associations, Chambers of Commerce, and a project identification unit for the Caribbean. The first project involves a grant to the Caribbean Association of Industry and Commerce for export promotion services. Another project involves the pairing of LAC and U.S. Chambers of Commerce to assist in promoting exports.

While these efforts have been helpful, it is generally felt that the area of export development and promotion is one that merits greater attention due to its record of success in inducing economic development.

Tourism

Tourism projects were financed during the 1960s and early 1970s. Several privately owned hotels were financed in India and Pakistan with Cooley loans. All of these projects were apparently successful.

A tourism program with assistance provided to the government was implemented over several years in Jordan to develop tourist sites. The implementation of this program had beneficial effects for private business. Private funds were always available at that time for hotel construction or establishment of related service industries. A 1967 project in Africa involved a $2.5 million loan to the Grands Hotels du Congo to assist in the construction of an intercontinental hotel in Kinshasa. The major investment was made by an international hotel chain. The project was successful and the hotel is in operation today. Tourism was also assisted in Egypt, where funds were made available under the CIP to finance equipment for hotels. A large regional program under the Regional Office for Central American Programs (ROCAP) was implemented in 1973 to develop tourism in Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica.

Although these programs were generally successful, the 1974 New Directions mandate effectively terminated the undertakings in this area due to its emphasis on programs directed at the poor majorities in LDCs.

Training

Training to support the private sector has taken the form of vocational skills training and management training (both long-term and short-term). AID was very active in training, particularly in the 1970s, but has been less active in the 1980s.

Vocational skills training. Vocational skills training programs provide semiskilled and skilled personnel to fill job requirements for the public and the private sectors. AID has been fairly active in technical assistance and funding to existing training institutes and has also helped establish a number of new institutes.

In Korea, AID provided technical assistance and funding for equipment for the Korean Institute of Science and Technology. In Jordan, a vocational training project has contributed to the construction, equipping and staffing of an institute which will turn out approximately 300 workers per year for the private sector. In Morocco, AID is financing a project which will provide industrial and commercial job training for women. Inputs include advisors, training in the United States, and training equipment. Students are being trained in drafting, electricity, electronics, accounting, and secretarial skills. Two projects in Egypt which benefit the private sector are a vocational training program to develop a regional model for a national vocational training system to provide skilled labor for private and public sector companies and a vehicle maintenance training program to train mechanics. In LAC, vocational training projects have served to provide direct support to the private sector to enable it to meet its own training requirements, via assistance to employer organizations, Chambers of Commerce and industry, and other private sector groups.

Development assistance has been provided to LAC private sector training firms which provide services to participating firms. PVOs have also received assistance allowing them to provide skills training to the poor.

Examples of the initiatives above include AID assistance in 1965 to the National Private Sector Council of Panama (CONEP) to survey the training needs of the Panamanian private sector and to assist in the creation of a semiautonomous training organization. In 1967, the National Industrial Apprenticeship Training Service (SENAI) in Brazil received technical assistance to improve its ability to estimate training requirements and to enhance its in-plant training support capability. From 1977 to 1978, AID financing was provided to the Federation of Voluntary Organizations (FOV) in Costa Rica to permit them to strengthen their efforts in training poor women. Approximately 200 volunteer workers have trained 1,550 poor women in skills such as industrial sewing, preparation of Christmas ornaments, and baking.

It is generally felt that most of the vocational skills training programs servicing the private sector have been successful. The more closely a training program is tailored to meet a specific demand based on a well-designed training needs analysis, the more useful the program to the private sector. At the time of this writing, few data were readily available on a significant population of vocational training projects, but general agency opinion tended to be favorable.

Management training. Management training has been provided in the United States for selected foreign students, such as those participating in the (LASPAU), (ASPAU), (AFGRAD) programs. Large scale reimbursable activities have been conducted in Brazil and Guatemala. While these projects have not been evaluated from the standpoint of their impact on the local private sector, it is generally agreed that exposure to U.S. management techniques through U.S. university programs is beneficial. It is generally acknowledged, however, that better coordination between the area of studies and actual employment demand in the host country is needed to ensure greater program efficiency.

Management training programs have also been developed and implemented in-country. Most results are positive, although a program implemented in Turkey in the mid-1960s was evaluated as having given no indication of noticeable results.

LAC loan and grant funding from 1972 to 1976 was instrumental in developing the Central American Institute of Management (INCAE) in Nicaragua. This private, nonprofit, multinational institution offers both MBA studies and specific training programs built around special requirements. It also provides consulting services on a fee basis to private and public institutions. However, the recent political turmoil in Nicaragua has necessitated the funding of a second campus in Costa Rica. An evaluation of INCAE (which received its AID-financed technical assistance from Harvard) conducted in 1976 noted that INCAE has a justified international reputation for high quality in its educational programs.

AID also provided assistance to the Panamanian Association of Business Executives (APEDE) as early as the late 1950s to allow APEDE to upgrade the quality of management skills of its members. In 1977, the Center for Graduate Studies in Management (CESA) was started to formalize graduate management studies. AID is now providing APEDE with assistance to provide management training to small entrepreneurs.

In 1963, with AID funding, ESAN, the graduate school of business administration in Lima, Peru, was initiated. It is a private, independent graduate school of business, offering an MBA and specialized executive programs. With AID assistance, it received technical support from Stanford University. ESAN is considered one of the best business schools in South America, graduating 70 students annually from its MBA program.

In Egypt, a Management Development for Productivity Program is intended to improve management in both the public and private sector industrial organizations. Approximately 200 managers from the private sector will be trained.

Management training programs are generally regarded as useful provided they respond to specific needs and are capable of becoming self-sustaining institutions over time, supported by trainees and employers. One means of expanding the management training institutes' activities and income base is that of external consulting, including operational practices (accounting, bookkeeping), pre-investment or feasibility studies and market research. INCAE and ESAN provide these services.

Technology Transfer

The transfer of productive technology to LDC enterprises serves to enhance productivity, improve product quality, and promote competitiveness in the world market.

Means of capitalizing on U.S. technology have included facilitation of joint ventures, provision of assistance to technology-oriented PVOs, and support to specialized technology transfer organizations such as the Joint Agricultural Consultative Corp. (JACC) and the International Executive Services Corps (IESC).

Joint ventures. The establishment of joint ventures in LDCs was facilitated primarily during the Cooley loan period, when local currency loans at somewhat concessional rates were made to U.S. corporations or their affiliates who intended to establish joint ventures or foreign branches in LDCs (see Section II.F.1). In these instances, U.S. technology was provided by the American partner, along with his equity investment in the firm. This combination of equity investment and "vested interest" technical assistance appears to have been instrumental in the success rate of the Cooley loan projects on the whole.

Since 1974 and the New Directions mandate, there have been few instances of AID-facilitated joint ventures, although the recent PRE efforts to provide more equity funding via cofinancing arrangements and support of the JACC are aimed at increasing U.S. overseas partnerships.

Private voluntary organizations (PVOs). PVOs such as the Appropriate Technology, Inc. (ATI), Technoserve, Inc., ACCION, the Institute for International Development, and the Partnership for Productivity have been helpful in providing some technical assistance to small enterprises to ensure the transfer of appropriate managerial and production technology. These efforts are more fully described under Section II.K (SSE Development) since most of their efforts are aimed at assisting smaller enterprises with basic managerial and operational skills, such as bookkeeping.

In the area of appropriate agricultural or production technology, ATI has been particularly active since its creation in 1977. ATI's stated goal is to implement appropriate technology projects which combine technology, financial support, technical assistance, and knowledge of development methods to produce positive, direct effects on employment, income, savings, capital formation, and productivity. Since its creation, ATI has provided over $11 million in financial and technical assistance through more than 200 grants to organizations in Latin America, the Caribbean, the Middle East, and the South Pacific.

Examples of ATI projects include the development of a charcoal briquetting process in Kenya where the Kilifi Plantations, Ltd., built pulverizers from used oil drums and starch from the cassava plant was used as a binder for the briquettes. A fish farming technique recently introduced in a large-scale capital intensive way in Africa is being scaled down to local conditions in the coastal lagoon areas of Togo. The adapted technology involves raising fish in nylon net enclosures in the lagoons rather than in manmade ponds and replacing food pellets used in large commercial operations by agricultural and household wastes present in the lagoon. Members of farm cooperatives are trained in these techniques.

As of 1983, ATI began focusing on three technological areas: agricultural product processing, local mineral resource development, and farm-related technology. ATI has current projects in 28 countries. The 1982 grant from AID to ATI amounted to $6.6 million. The results of its projects are generally considered very satisfactory.

Agribusiness technology. During the 1970s, rural development programs became priority areas, particularly in light of the "new directions" mandate with its emphasis on basic human needs. However, most of these programs were geared to the individual farmer through university or government programs, rather than private sector firms.

One exception was the LAAD agribusiness program in the 1970s. It was found in the LAAD program that outreach operations to local smallholders could improve their economic and social well-being, particularly if backward linkages existed and if technical assistance and agricultural credit were provided by the agribusiness rather than by the host government. The ALCOSA project in Guatemala was an outstanding success in the area of agribusiness outreach to local smallholders.

In the 1980s with the renewed emphasis on private sector programs, technology transfer in the agribusiness area was recognized as a strong potential vehicle for private sector development. To facilitate the technology transfer process and to attract private U.S. investment in LDC agribusinesses, JACC was established and has received financial support from PRE. The JACC represents a number of medium-sized U.S. agribusinesses which, without the JACC, would most probably not be involved in LDC agribusiness projects.

Management technology. A key technology transfer agent in the area of management and other technology has been the International Executive Services Corps, a PVO serving primarily local private enterprise and some government agencies in over 30 countries in South and Central America, Africa, East Asia, and the Middle East. Approximately 40 to 50 percent of its funding comes from AID (PRE has recently taken over management of AID's funding to IESC). IESC's clients are all charged fees for the services provided by IESC's corps of retired executives.

The program is administered abroad by full-time country directors who reside in areas of greatest IESC activity. Country directors generate assistance requests and service both clients and volunteers in connection with assignments. Advisory councils are made up of local leaders whose knowledge of the host country's needs helps to focus and speed the applications of IESC's services in that country. IESC has advisory councils in 49 cities with a total of over 300 business leader members.

Projects approved in IESC's Stamford headquarters go to the executive recruiters there, who match retired American businessmen with the overseas client requesting specific advice. There is a file of over 8,500 registered volunteers.

IESC to date has engaged in nearly 9,000 technology transfer projects over 20 years, which have resulted in increased employment, increased foreign private sector investments, and, in about 1,500 cases, enduring relationships with U.S. firms.

The IESC program was very favorably evaluated. It is endorsed by AID, State, Commerce, U.S. Agency for International Development missions (USAIDs), U.S. ambassadors, host governments, and U.S. and LDC private companies. It enjoys an excellent reputation within the agency for providing prompt and effective assistance to a variety of management and production problems and for instilling sound problem-solving techniques in the local managers with whom the IESC executives work.

Two other important management technology transfer projects of the late 1960s and early 1970s are the National Bureau of Standards (NBS) project and the Denver Research Institute project. The former was a nine-year effort that was very successful in helping countries develop standards institutions suitable to support domestic and external commerces. The latter was a long-term project to upgrade the management capability of industrial research institutes.

The list of other management technology transfer projects supportive of the private sector is extensive, but the above are generally accepted as representative of the more successful initiatives, all designed to fill a specific need in given LDCs.

Small-Scale Enterprise (SSE) Development

A 1981 study of small-scale enterprise (SSE) development as undertaken by AID and other funding agencies reports that SSE programs have been considered effective tools to assist the poor majorities in LDCs in line with the "new directions" mandate since they are generally labor-intensive, have a lower per-job cost and lower capital costs, and often offer job opportunities for the very poor and women. However, it was only as of 1980 that SSEs became a major target of donor assistance. Employment generation had not been one of the original targets of the BHN program. In fact, the Small Enterprise and Employment Unit in AID was not created until March 1980 and was not given divisional status until 1981. Until 1980, SSE activities were supported only when they had a role in implementing BHN.

Between 1952 and 1980, over 775 AID SSE projects (or projects with SSE components) were initiated in LDCs. Most were in Asia and LAC and had been initiated prior to 1973. Of the 240 SSE projects initiated in Asia, 95 percent were initiated between 1952 and 1973. Half of them were implemented in Korea and Taiwan.

LAC has been the second most active bureau in SSE projects, with a total of some 230 projects implemented in 23 countries since 1952. Seventy-five percent of LAC's projects were implemented before 1974. Most LAC projects involve financial and technical assistance provided through ICIs. LAC's ability to implement these programs successfully has been attributed in part to the presence of more extensive physical infrastructure, more developed human resources, and a policy climate generally favorable to the private sector among the host countries, as compared to conditions in Africa or the Near East.

In the Near East, the only current SSE activity is in Egypt. (Pre-1974 activity involved larger industrial projects with small SSE components in countries such as Greece, Iran, Israel, Lebanon, and Tunisia.) In Africa, many SSE projects are part of a larger rural development program. PVOs are the most frequent delivery vehicles, and the most successful programs have been in the more developed countries such as Kenya and Nigeria.

Many SSE technical assistance projects are implemented by PVOs. There are four centrally funded PVOs (in addition to ATI and IESC, discussed previously) that receive matching grants from AID.

Technoserve, Inc. (TNS) works with low-income personnel and development institutions in Africa and Latin America. It was started in 1968 and has assisted more than 150 enterprises in more than a dozen countries, most with fixed assets between $25,000 and $250,000. Many efforts have involved savings and loans, cooperatives, and enterprises involved in livestock or primary agricultural production. Sixty percent of TNS financing comes from AID. It would appear that its approach to institutional development is successful, particularly as concerns management and accounting systems, policy advice, and training.

ACCION International/AITEC was created in 1965 to provide long-term technical assistance to rural and urban socioeconomic development programs in Latin America. It has been active in experimental programs in community development, cooperatives, savings and loans, industrial development and management. ACCION has recently begun to concentrate on microenterprises. It was not successful in a program of equity financing to SSEs.

Partnership for Productivity (PFP) was founded in 1969 as a nonprofit corporation to support SSEs in developing countries and was converted to a foundation in 1980. PFP is generally considered successful in its projects and is appreciated for the time it takes to research project problems fully which gives the organization a high degree of acceptance in the local communities with clients and the public. PFP relies heavily on a "bicycle brigade" of trained local representatives, which has proven a cost-effective delivery mechanism.

International Institute for Development, Inc. (IIDI) was founded as a PVO in 1971 with the purpose of creating jobs in LDCs through entrepreneurial enterprise. Most businesses it helps establish are agricultural or food-related. In 1980 IIDI had 56 projects, most of which involved matching local entrepreneurs with U.S. investors and sponsors. IIDI has a generally successful record, although it has been criticized for inadequate communications and insufficient service to its U.S. investors and sponsors.

The AID Office of Urban Development devised the Program for Investment in Small Capital Enterprise Sector, or PISCES program, which is aimed at the smallest-scale economic activities of the urban poor. Its results are considered satisfactory.

The summary conclusions of the SSE program evaluation report (which the report emphasizes as being directional but not definitive, since the data available on the SSE programs are limited) indicate that a combination of financial and technical assistance is needed to support SSEs; that financial assistance works best when explicit standards for subloans exist and are respected; that financial resources tend to be allocated to better-established SSEs, as is technical assistance when it is provided along with the funding; that there is generally too little technical assistance in SSE projects; that technical assistance as an approach fails more often than other approaches because it goes more slowly than projected; and that PVOs appear to be effective means of providing technical assistance to SSEs.

Examples of successful SSE projects include the Paraguay Productive Credit Guaranty Program, whose goal was to establish a self-sustaining guaranty fund to lessen risks in lending to SSEs (the fund by 1980 was 20 times larger than that targeted in the project paper. The project generated over 600 subprojects, and some 3,900 new jobs, and helped to improve the profitability of firms that were assisted. (Despite the impressive success, the Bank of Paraguay inexplicably withdrew its support in 1980.)

The Nigerian Industrial Development Project (1961-1972) was another successful project. It is considered the most ambitious enterprise and industrial development project in the region and enjoyed considerable success in expanding sales, improving operations, and increasing profits of the companies it assisted. It also created numerous jobs. The Nigerian project was especially effective in strengthening SSEs by integrating technical advisory services and financial assistance, which resulted in the more rapid self-sufficiency of the companies assisted.

The Ecuador Small Enterprise Assistance Project (1970-1977) provided 295 subloans to SSEs, mainly in the areas of metalworking, plastics products, small appliances, furniture, clothing, and wood products. The project was evaluated as an excellent resource transfer mechanism and as having contributed to strengthening the Government of Ecuador's institutional funding mechanism. The small industrial sector was expanded to 22 cities in Ecuador, with 535 new jobs created in the 162 small companies sampled in the evaluation. Total production in the sampled firms increased by 31 percent over the previous year, with an average increase of 72 percent in the use of raw materials.

Examples of poor SSE projects include the Bolivia Small Farmer Organization Project, in which the proposed credit system was poorly designed and the project implementation was inefficient. The cooperative staff was not qualified and there were frequent conflicts between the cooperative and the ICI designated to assist it. No evaluation was made, however, of the impact of the project on the rural poor. The evaluation was limited to the effectiveness of the institutional operations.

The results of the Entente Fund African Enterprises Project were considered adequate from the standpoint of the number of enterprises assisted financially, but it was less successful in its technical assistance efforts because the technical assistance office was maintained separate from the development banks which were receiving the SSE funds. It was also found that the Entente Fund project was using too many of its AID-supplied funds in the most developed of the five Entente Fund countries. Larger firms were favored over the smaller ones, and insider contacts were used to obtain funds. The requirement for more specific loan criteria was emphasized, as well as the need for enforcement of those criteria. The key recommendation, however, was the provision of good and easily accessible technical assistance.

Generally, the SSE development programs are considered very useful in meeting the goals of the BHN mandate through increased employment of the urban and rural poor. The costs of implementing a truly effective program can be relatively high on a per subloan basis because considerable technical assistance is required to increase the chances of sustaining the enterprises established over the long term. However, these costs are less onerous when they are calculated on the basis of the total number of new jobs created.

Agency monitoring of the ICI implementing the SSE loan program is necessary because a certain tendency to assist the larger scale firms does exist. Many of the problems in the subloan process can be resolved by more specific subloan criteria. It appears that sufficient debt financing now exists for SSEs and that the increasing need is one of equity financing for the small entrepreneur without access to capital. On the whole, the employment benefits derived from SSE programs and the reasonable per job cost make this program a key area for economic development, if sufficient technical assistance is provided.

CURRENT BUREAU FOR PRIVATE ENTERPRISE POLICY AND PROGRAMS

Policy

As set out in the Bureau for Private Enterprise Policy Paper, May 1982, the goal of the agency's private enterprise initiative is to "foster the growth of productive, self-sustaining income and job-producing private sectors in developing countries using the financial, technological, and management expertise of the U.S. private sector, indigenous resources, multilateral institutions, and Agency resources where appropriate." PRE is to spearhead that program.

The objectives of the private enterprise initiative include: (1) along with host country, international financial institutions, and U.S. private investors, assist in financing productive and developmentally desirable private enterprises in priority sectors in LDC; (2) bring together LDC investment opportunities, U.S. and host country capital, and experienced management in order to transfer technical, managerial, and marketing expertise from the United States to LDCs; (3) stimulate conditions conducive to the flow of U.S. and host country private capital into productive investments in LDC priority sectors.

The methods for accomplishing the above include: (1) facilitating LDC project identification, development, promotion, and financing; (2) helping to establish, finance, and improve private development finance corporations; (3) encouraging the growth of LDC capital markets; (4) providing counsel to hose countries on how to create climates conducive to the growth of private investment; (5) creating in capital-exporting countries interest in portfolio investments in LDC enterprises; (6) helping establish managerial and technical training institutions to support the private sector; and (7) promoting and financing business relationships between U.S. and LDC groups with similar private sector interests.

The challenges identified as facing AID in achieving these objectives include: (1) the limited amount of AID expertise in private sector finance and business management; limited contact with U.S. firms; (2) limited knowledge of capital and marketing needs of LDC private firms; (3) lack of AID policy and procedures for identifying and implementing private sector projects in a timely fasion; and (4) limited recent experience in counseling host governments on private sector policy.

The role models identified for AID's program included: (1) the IFC, with a 25-year track record and a 4:1 average financial leverage, and (2) foreign industrialized country government agencies that promote close trade and aid ties among their own private sectors and LDC firms and which play a catalytic role in assembling financial packages and providing technical assistance.

A natural interface with other U.S. Government agencies was also projected, especially with OPIC and the Exim-Bank.

The PRE investment program strategy, as an agent for experimentation in AID private sector development, included three types of investment: (1) cofinancing highly developmental projects with commercial banks and other financial institutions; (2) capitalization of privately owned ICIs which serve the private sector; and (3) direct investment in select agribusiness, industrial, leasing, or other business ventures in LDCs where replication by other enterprises would assist private sector development.

This investment activity translated into three functional activity categories to be pursued with central and regional AID bureaus: (1) identification and screening of investment opportunities for possible AID funding; (2) serving as a catalyst to assemble financing for investment opportunities; and (3) providing advice and technical assistance to host countries in the areas of investment policy and establishment of financial intermediaries to prospective investment partners on developing projects for AID consideration and to public and private host country institutions on building investment infrastructure and providing managerial training.

The investment program's target countries were those with an existing AID mission that possesses a viable private sector and represent strategic importance to the United States. Sectoral priorities identified for immediate consideration included agribusiness, ICIs and other capital market elements, leasing of capital equipment, manufacturing, and management training.

Investment strategies recommended in the policy paper (certain being immediately possible and others requiring new authority) included: (1) cofinancing with commercial banks; (2) financing the interest rate differential; (3) convertible and subordinated debentures; (4) guaranties provided by AID (requiring the creation of an authorized reserve fund to back up the guaranty); (5) equity investments (also requiring special authorization); and (6) stock options.

The long-term budget strategy of PRE was defined as establishing its investment activities on a self-sustaining basis, so that yearly appropriations would no longer be necessary and so that the overall private sector program could be run as a business. The recommended means of achieving a self-sustaining budget was the reflow authority once possessed by the agency in which PRE would take the funds received as loans when repaid and apply them to new loans without congressional appropriations. To do so, the Foreign Assistance Act would require amendment, which has happened recently.

Programs

The following is a summary of the administrator's remarks in his FY 1984 congressional presentation, as concerns PRE's strategic focus and its FY 1982, 1983, and 1984 programs.

The PRE bureau's focus has concentrated on the following five areas: (1) investment environment, including financing studies on the investment environment in five countries, resulting in recommendatins to the concerned governments on changes needed to make the environments more conducive to business development; (2) capital market institutions, including studies and recommendations on how to improve existing capital market systems to attract resources and provide financing for private enterprises; (3) management and vocational training, including development of programs addressing training needs; (4) technology transfer, including support to JACC and IESC to explore ways of transferring agribusiness technology and management, production, and marketing know-how, respectively, to LDC companies for increased productivity and product improvements; and (5) investment promotion, including efforts to promote indigenous businesses and joint ventures with U.S. businesses in priority sectors, e.g., capitalizing private ICIs and direct lending in agribusiness, health and medical services delivery, and small and medium-size manufacturing enterprises.

The PRE relationships with other regional and central bureaus included coordination of its major investment and grant proposals with the respective regional bureau and country mission; the response to specific mission requests for assistance in private sector development matters; the creation of a formal "private sector officer liaison committee" to discuss policy issues and specific projects; and the development of the set-aside program in which PRE provides assistance to selected country missions on private enterprise strategies and projects.

FY 1982 Program ($13.5 million). FY 1982 was a start-up year, involving policy development, staff recruitment, reconnaissance missions to certain target countries, and development of relationships with the U.S. business community. Reconnaissance missions ($.25 million) included senior U.S. executives sent to make program recommendations in Egypt, Pakistan, Sri Lanka, Indonesia, Thailand, Haiti, Ivory Coast, Kenya, and Zimbabwe.

Relationships with the U.S. business community ($1 million) involved U.S. business organizations and associations, including Business International, Young President's Organization, and the Conference Board, which will, respectively, conduct studies on investment environments in five countries, conduct hands-on entrepreneurial problem-solving exercises in seven countries, and implement roundtable discussions among medical directors from U.S. companies on providing health and medical services to employees.

The 1982 portfolio of activities included $12.3 million allocated as follows:

- Investment environment ($.23 million). An analysis was made of possible venture capital institution in Peru and a discussion paper produced on a possible merchant banking institution in Pakistan.

- Investments and capital market development ($4.8 million). Several medium-term loans at fixed, near market rates were negotiated to private ICIs for the provision of credit to SMSEs, to a leasing company in Peru for seed capital, to a Jamaican life insurance company for equity or debt investments in local rural SMSEs and to the Women's World Bank, a U.S.-based venture capital firm providing high-risk capital to microenterprises.

- Management training ($1.1 million). Management training consulting teams were sent to six countries and a $1 million grant was provided to the Institute for Management Education of Thailand. The Young President's organization conducted short-term programs, and the Center for Entrepreneurial Management conducted a series of seminars in Pakistan to assist start-up businesses. Similar seminars were scheduled for India and Bangladesh.

- Technology transfer ($5.8 million). PRE provided support ($500,000) to the JACC, which represents small and medium-sized U.S. agribusinesses and which set up joint agricultural consultative committees for Thailand, Sri Lanka, Indonesia, and the Caribbean. The IESC also received $5.3 million for project work in LDCs. With PRE support, IESC has opened an office in Kenya and in the Caribbean. It also added an agribusiness expert to its Thailand office.

- Investment promotion ($.359 million). PRE supported activities to promote joint venture and indigenous private investment in LDCs, including the establishment of the Caribbean Investment Promotion Office with UNIDO and a joint AID/OPIC promotion office with U.S. SMSEs as the target investors.

- PRE has also set up a feasibility study financing program to promote investment in which PRE finances up to 50 percent of a feasibility study, up to a maximum of $50,000. During FY 1982, PRE financed two such studies, one in Egypt and one in Pakistan.

Bilateral USAID mission programs included emphasis on increasing policy dialogue and private investment promotion. A project in Jamaica provided feasibility study and loan financing to agribusinesses. Another project in Thailand strengthened the capability of a Board of Investment to promote that country's investment potential.

FY 1983 Program ($26.8 million). In addition to managing the FY 1982 portfolio, programs were undertaken with reconnaissance teams ($.2 million) to send missions to Peru and Sudan, to be followed by Costa Rica. A mini-mission concept was adopted for Africa with a regional focus for a certain number of subject areas. As concerns relationships with U.S. business community ($1 million), Indefinite Quantity Contracts (IQCs) were established which provide expertise available to regional bureaus and country missions in agribusiness analysis and financial services.

The FY 1983 portfolio of activities included the following:

- o Investment environment ($.6 million). Other advisory projects, particularly as concerns Sri Lanka and Jamaica, are being implemented to develop stronger capital markets and a rewrite of an outdated "companies act," respectively. Assistance was also planned to governments interested in evaluating the possibility of divestiture of government-owned corporations.

- o Investments and capital market development ($14 million). Mechanisms included assistance to venture capital firms, particularly in Asia and Latin America and to merchant banks in Egypt and Pakistan. Cofinancing with U.S. banks in Latin America and the Caribbean was evaluated and large cofinancing projects were implemented in LAC and for Asia.

- o Productive Credit Guaranty Program. PRE began to experiment with more streamlined mechanisms through private institutions for use of this authority in the context of PCGP projects in which AID would extend a guarantee directly to the commercial bank involved, which would supervise the loan portfolio, manage the fee income, and provide technical assistance to client companies which must be self-help or agricultural-related rural businesses.

- o Management and technical training ($2.5 million). Support begun in FY 1982 was continued in Pakistan, Kenya, and Jamaica. Projects with private sector training institutes, notably a technical training institute in Peru, were implemented along with additional entrepreneurial seminars, particularly an LDC-to-LDC entrepreneurial training program jointly sponsored with UNIDO.

- o Technology transfer ($7.5 million). Both JACC and IESC received continuing support, and U.S. cooperatives were studied as possible providers of technical assistance to LDC organizations.

- o Investment promotion ($1 million). Investments were made to support nontraditional export businesses.

Bilateral USAID programs continued support to policy dialogue and to investment promotion activities in key sectors, with attention to ICIs to serve SMSEs better and to local business associations and local and regional training institutes.

FY 1984 Program ($26.4 million). Exploratory missions are scheduled to taper off in this fiscal year as the focus becomes one of assisting in policy dialogue, ensuring financial institution building to strengthen capital markets, and assisting LDCs in developing their own or access to U.S. technical and marketing expertise.

Reconnaissance missions ($.15 million) will decrease, although the mini-mission concept will continue with emphasis on small business start-up and expansion, vocational skills training, revisions in company laws and acts, tax legislation, and capital market institutional development. Relationships with the U.S. business community ($.85 million) will involve increased liaison between U.S. small and medium-sized firms and their LDC counterparts, to encourage particularly joint ventures in agribusiness and health, provision of marketing information, transfer of appropriate technology, and strengthening U.S. business ties to LDCs for investment, marketing, and technical assistance.

The FY 1984 portfolio of activities (the balance--$25.4 million) includes:

- o Investment environment ($.5 million). Attention will be given to assisting LDC governments in divestiture of parastatals, via increased general public and employee ownership.

- o Investments and capital market development ($15 million). Aimed at methods of using P.L. 480 and commodity import funds available in local currencies for private enterprise related activities; at more cofinancing efforts with multilateral, local, or U.S. banking institutions; at seeking the authority to create a revolving fund to obtain nonappropriated funds on a self-sustaining basis; at participating in R&D limited partnerships to develop and apply technologies appropriate for LDCs, and at experimenting with investments in health and medical services delivery which serve as alternatives to public institutions providing such services.

- Management and technical training ($2 million). Assistance focused on developing formalized relationships between United States and host country training institutes, including such U.S. entities as AMA and the American Assembly of Collegiate Schools of Business, with whom curriculum development assistance, student and faculty exchange, and special conferences will be developed.

- Technology transfer ($7.4 million). Emphasis will be on the health and medical services sector, including the creation of special advisory councils and the evaluation of limited partnership creation to finance health technology, along with continued support to JACC and IESC.

- Investment promotion ($.5 million). Additional agribusiness workshops will be sponsored, particularly in Africa, along with health-related business activity workshops and possible regional investment promotion offices, with priority again given to African nations which have strong pro-private sector policies.

The bilateral USAID programs will continue with increased set-aside activities.

Table 4.4 shows the PRE budget by subject area over the past three years with a summary of subject area activity for the period.

Based on FY 1982-1983 experience, which is still quite limited, PRE has generally concluded that a far more vocal role is required within the agency to direct and coordinate private sector efforts; that public policy dialogue is most feasible in conjunction with other bilateral or multilateral donors, in instances in which AID assistance is the major portion of the host country's foreign assistance, or in instances in which specific requests for policy advice have been received; that local AID missions require considerable guidance in developing private sector programs; that cofinancing arrangements with U.S. private lenders are feasible and present good leverage potential; that good outreach possibilities exist within the context of larger agribusiness projects; that extensive and specialized staff time is required for project development and monitoring; that project identification responsibilities must be clearly defined and monitored in the context of loan agreements; that relationships with the U.S. private business community (Young President's Organization (YPO), Business International (BI), Conference Board, etc.) have been very profitable; that the IESC represents a very valuable and flexible technical assistance resource; that proper PRE project evaluation guidelines are required to ensure valid subsequent project feedback; and that better coordination is needed among the private sector development efforts undertaken by USAIDs, the PRE Investment Office, and the PRE Program and Policy Review Office.

TABLE 4.4

BUREAU FOR PRIVATE ENTERPRISE
BUDGET BY SUBJECT AREA (FY 1982, 1983, 1984)

SUBJECT AREA	FY 1982	FY 1983	FY 1984
POLICY DIALOGUE	$ 950	$ 1,150	$ 2,500
INSTITUTION BUILDING	4,850	12,200	10,000
TECHNOLOGY TRANSFER	5,900	11,650	12,900
TRAINING	1,600	1,400	500
INVESTMENT PROMOTION	400	400	400
TOTAL	$13,700	$26,800	$26,400

SUMMARY TO DATE

POLICY DIALOGUE efforts focused on providing assistance to missions and host countries on:

- investment laws, regulations, policies;
- framework for capital market institution development;
- strategy development for divestiture of state enterprises.

INSTITUTION BUILDING has been achieved through PRE investment program:

- creation of new capital market institutions to serve small business (e.g., leasing, venture capital);
- expanding capabilities of existing institutions into other areas (e.g., commercial banks into agribusiness lending).

TECHNOLOGY TRANSFER principally accomplished through IESC and JACC:

- utilizing U.S. expertise adapted to LDC environment;
- focus on agribusiness.

TRAINING programs have focused on management and vocational needs supported by local businesses:

- Institute of Management Education in Thailand addresses short-term mid-management course needs;
- Vocational training institute in Peru is business community's response to real training needs.

INVESTMENT PROMOTION activities are limited, focusing on:

- investment attraction by selected LDCs, training promotion officers to "market" their respective countries;
- collaboration with OPIC.

LESSONS LEARNED

Most Successful Programs

In synthesizing lessons learned over the years from AID development experience, it is perhaps useful to begin with a summary of the positive elements of the successful programs. Two major programs appear to have been the most successful: technology transfer and foreign private investment promotion.

The technology transfer program, with its joint venture, agribusiness, PVO, and management technology transfer mechanisms, has performed the extremely important function of enhancing LDC productivity, improving their product quality and promoting their product competitiveness in the world market.

The value of the transfer of U.S. technology cannot be calculated in dollars and cents since it has considerable impact on the long-term growth among LDCs. The ability to achieve a competitive status internationally for the LDC will often depend upon the accessibility of that technology, while the maintenance of low-cost, small-scale agricultural and industrial operations for local production will depend upon good adapted technologies.

U.S. efforts in joint ventures, licensing agreements, and adapted technology transfer have and continue to be highly effective in this area.

The foreign investment promotion program has also achieved considerable success, especially the Cooley loan program and the Housing Guaranty Program.

The Cooley loan program appears to have achieved considerable benefits from the standpoint of both development concerns (creation of productive industries and export of U.S. private capital, management skills, and technology to countries in which U.S. firms would otherwise have been inactive) and U.S. business concerns (dollar reflows to the United States from royalties, licensing fees, etc.; expansion of U.S. capital goods and raw materials exports; political value of good working relationships between U.S. and indigenous businesspersons).

The only criticisms registered of the program involved the lack of funds in certain sought-after countries and limited staff time resulting in loan processing delays.

The success of this program in internationalizing private enterprise clearly underlines the importance of linking trade and aid to the development process.

The housing guaranty program, in which U.S. investment in the form of debt capital from the savings and loan system was promoted by the provision of a U.S. Government guaranty for the full amount of the investment, was also quite successful as a foreign private investment promotion mechanism, although it is not possible to determine precisely how many of the loans would have been provided anyway had the guaranty not been available. The program was effective both in attracting U.S. private capital and in achieving development benefits, notably improved housing. The default rate for the housing guaranty program is very low, as compared with that of other programs.

Two other programs which appear to have achieved satisfactory results are the capital market development program through ICIs and training. The former has generally been effective in creating self-sustaining financial institutions, in mobilizing external resources, in achieving effective transfer of resources to a large number of recipients, and in providing loan monitoring services (alleviating the drain on limited AID human resources). The potential does exist, however, for misallocation of resources if internal policies are distorted or if subloan criteria are not clearly spelled out or enforced. On the whole, however, the capital market development program via ICIs has functioned well.

Training programs which have responded to predetermined and well-articulated needs and which have become or show promise of becomming independent, self-sustaining entities are considered very valuable to private sector development. More evaluation of the direct impact of training programs on private sector enterprises would be useful in order to design better new programs and to adjust existing ones.

Least Successful Programs

Two programs appear to be less successful than most of the other programs. These are the industrial development program via the DLF's direct loans and the policy dialogue program via program loans.

The ineffectiveness of the DLF loans appeared to stem from poor management of the enterprises and insufficient capitalization. Little direct management or technical assistance from foreign investors was provided, and this perhaps contributed to the failures. Problems were also attributed to the highly staff-intensive nature of the program and to the specialized staff skills required. Finally, the fact that there were very limited institutional benefits from the program added to its negative overall rating.

The program loans are difficult to evaluate objectively since they were provided to strategically important countries. The "conditioned" loan mechanism did not appear efficient in achieving targeted policy modifications. Comments to the effect that the loans were difficult to negotiate, produced modest results at best, and may not have even been necessary for some of the policy modifications involved tend to negate the mechanism as an effective policy formulation tool unless considerable changes in the program development methodology were instituted. (Changes involving more specific and fewer policy conditions with better review processes were recommended, as was the strategy of diminishing aid as progress is made.)

GENERAL CONCLUSIONS

There are two primary forms of assistance to LDCs: the first involves provision of technical assistance (transfer of know-how, training, etc.); the second involves the provision of capital (transfer of funds for credit, equity, etc.).

On the whole, AID's function is to transfer know-how to the LDCs, to permit them to develop their economic resources. Technical assistance serves normally to effect the transfer and develop skills, while capital assistance normally serves to make that know-how more productive. Both have important roles.

The form of assistance to be provided for any given program should be carefully evaluated. A knee-jerk approach to either technical assistance or capital transfer should be avoided.

The review of the agency's history of private sector programs indicates the usefulness of a combination of technical and capital assistance. In addition, the following general conclusions are drawn:

o The need for capital markets and institutions to support these markets in LDCs is generally present, but the key problem is a lack of know-how rather than a lack of funds. Indeed, the need for additional credit is no longer pervasive in LDCs. (When capital is lacking, it tends to be equity capital and not credit.)

o One of two conditions should determine whether investments are made in the LDC private sector: the recipient should have the technology and know-how to effectively use the investment, or the required technology and know-h[illegible] should be provided concurrently with the investment.

o Assistance to smaller enterprises should be provided for start-up purposes or early expansion only if a growth potential exists. Assistance should not be provided for "bail out" purposes.

o The most successful private enterprise assistance programs have direct ties to U.S. firms and businesspersons.

o The most successful private sector programs have been those that were demand-driven, whether they involved technical assistance or investments.

o Guaranties appear to be effective means of attracting U.S. private investment to replace public sector investments.

o In capital allocation or reallocation, equity should be emphasized. The creation of new institutions or the expansion of existing ones geared to provide equity should be considered (e.g., venture capital firms or investment banks).

o Cofinancing arrangements appear to leverage private sector funds for development assistance effectively, although AID programs with private cofinanciers are still in the experimental stage.

o Long-term commitments may be necessary in certain private sector programs to ensure success, but in all instances, the goal of creating or developing independent, self-sustaining (nonsubsidized) institutions should be emphasized.

o Successful experiences and an analysis of the reasons for their success have not been shared within AID, nor with other USAID missions, U.S. embassies, ICIs, or local entrepreneurs.

o The lack of a centralized and self-critical management process within AID for private sector initiatives has resulted in a concentration on projects rather than programs, and in limited replication of good initiatives with occasional continuation of poor ones.

o AID and PRE currently lack the adequate organization and properly trained personnel to implement the private enterprise initiative effectively.

o In summary, every opportunity to engage the U.S. private sector in development programs should be taken to obtain their know-how, capital, and markets. Opportunities to provide benefits in exchange for them (i.e., dollar reflows and increased exports) should also be promoted. All opportunities to assist private enterprise growth, particularly vis à vis the public sector, should be exploited through a combination of demand-driven technical assistance, training, private institution building, policy reinforcement, and capital transfer.

APPENDIX A

NON-AID U.S. AGENCY PRIVATE SECTOR PROGRAMS

International Trade Administration

The International Trade Administration (ITA) of the U.S. Department of Commerce, through district offices in 48 major U.S. cities and 127 foreign commercial posts in 67 countries, offers a wide range of export promotion programs for U.S. companies interested in pursuing business opportunities in developing nations.

ITA identifies trade leads overseas, investigates foreign markets for U.S. products and services, outlines export documentation requirements, locates overseas agents and distributors, disseminates market information, and provides specialized export counseling to U.S. businesspersons.

In 1981, ITA programs and counseling services helped over 5,000 companies export for the first time or to a new market. Export shipments by these firms were, on the average, less than $300,000.

In addition to export counseling, ITA hosts trade fairs, exhibitions, and trade missions throughout the world. ITA conducts special seminars throughout the country on "How to Form Export Trading Companies" (ETCs) to help U.S. companies learn how to take advantage of the export trading company legislation. ITA makes available to the business community guidelines, rules, and application forms for export trading company operations and has set up a clearinghouse to match up companies interested in forming export trading companies.

Office of the U.S. Trade Representative

This Cabinet-level agency is responsible for the direction of trade negotiations, formulation of overall trade policy, and supervision of bilateral and multilateral negotiations pertaining to trade. It represents the United States at meetings of the General Agreement on Tariffs and Trade (GATT) and the Organization for Economic Cooperation and Development (OECD) and in negotiations with the United Nations Conference on Trade and Development (UNCTAD).

The Overseas Private Investment Corporation

The Overseas Private Investment Corporation (OPIC) is a self-sustaining U.S. Government agency created by Congress in 1969. Its purpose is to encourage U.S. private investment in friendly developing nations as a means of accelerating the economic and social progress of these countries. OPIC provides incentives to the U.S. business community through its political risk insurance and finance programs, which are available in some 100 developing countries.

OPIC programs are extended for new projects or the expansion of existing enterprises which are financially sound and which significantly benefit the host country in terms of new jobs and skills, capital generation, and reduced import dependence.

OPIC's insurance program provides coverage against three contingencies: (1) inconvertibility of local currency and return of capital; (2) expropriation; and (3) damage resulting from war, revolution, or insurrection. OPIC policies are generally written for 20 years.

OPIC's finance programs fall into two broad categories: (1) financing through direct loans of up to $4 million to smaller businesses--companies with annual gross sales of $120 million or less--generally on a 7-12-year basis; and (2) all-risk loan guaranties of up to $50 million to U.S. lenders providing funds for overseas projects.

OPIC also provides partial funding for preinvestment feasibility studies (up to $100,000) and various special incentives to smaller businesses.

<u>The Export-Import Bank</u>

The role of the Export-Import Bank of the United States is to aid in financing export sales of U.S. goods and services through a combination of loans, loan guaranties and export credit insurance. The Export-Import Bank Act instructs the bank to provide financing for U.S. exporters competitive with that offered by foreign governments. Its role is to supplement, but not compete with, private financing. Exim-Bank targets its resources toward those transactions which would not go forward without their involvement.

The bank's programs are divided into two functional categories: (1) buyer credit programs, comprising loans from Exim-Bank and guarantees on financing provided by the private sector, generally from commercial banks to foreign buyers of U.S.-made equipment for projects or products which require repayment terms of five or more years; (2) supplier credit programs, covering export transactions funded by the private sector and generally repaid within five years. In the commercial bank guarantee program and export credit insurance programs, the private sector extends the financing, and Exim-Bank assumes most of the risk of non-payment by the foreign buyer. A stand-by loan commitment is available from

Exim-Bank to U.S. commercial banks that provide fixed-rate financing for medium-term export sales. A large part of the supplier credit program covers transactions with a U.S. value of less than $5 million.

Commodity Credit Corporation

The Commodity Credit Corporation of the Department of Agriculture administers export sales and donations for foreign use through other agencies. It also provides export guaranties to foreign buyers. Its Foreign Agricultural Service gathers information worldwide through representatives stationed in 70 U.S. embassies, develops export data to support trade, and works to reduce trade barriers. Its Office of International Cooperation and Development (OICD) is responsible for international and technical cooperation for development assistance programs.

U.S. Trade and Development Program

The objective of the Trade and Development Program (TDP), under the International Development Cooperation Agency, Department of State, is to promote overseas trade-based development and U.S. exports of development technology by funding project planning to help U.S. companies compete for, and participate in, major public sector projects in developing countries.

TDP sponsors a variety of preproject services, including project identification and mission feasibility studies and workshops, directed at promoting the TDP program or U.S. private sector contracts in support of major development projects. During FY 1979-1981, TDP financed 661 activities costing $1.8 million for 164 projects which resulted in contract follow-ons to U.S. business of $521.6 million.

The TDP Reimbursable Grant Program provides grants to U.S. companies considering an equity investment in a project. The grant enables U.S. companies to analyze the technical, economic, and financial aspects of a proposed investment project and to develop data for planning. If the company decides to invest, the cost of the feasibility study must be reimbursed.

APPENDIX B

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5.

INVOLVEMENT OF PRIVATE ENTERPRISE IN THE AID PROGRAM

By John C. Bierwirth

INVOLVEMENT OF PRIVATE ENTERPRISE IN THE AID PROGRAM

Growth in the private sector of the less developed countries (LDCs) would be very beneficial to the countries themselves and should increase the likelihood of improving relationships with the United States. The way in which development might take place constitutes the problem to be handled.

A given LDC may not even have in place the beginnings of a private enterprise system. Then the only possibility of "planting a seed" may be by introducing a U.S. private company as a coventurer with a nationally owned company in the country.

The Agency for International Development (AID) program to date, where it concerns private enterprise, holds promise of being successful. The AID staff has recognized that it is not possible to build up an in-country AID organizaion and expect to staff that organization with people who are experienced both in private enterprise and in operations in the countries in question. Such efforts are being attempted by some of the major U.S. banks and they would be willing to testify how difficult it is to develop an adequate experience level, even if one begins with experienced bankers.

It is possible, however, to take advantage of the experience and personnel in other organizations. AID has proceeded in this direction in a way that promises success. Further ventures of this sort should be encouraged. The essential first step is the setting up of an intermediate financial joint venture in which local financial institutions participate with the purpose of promoting projects that fit the overall policy developed in Washington by AID. (The availability and terms attached to AID funds should and currently do permit the agency to induce financial institutions' acceptance of the "purpose aspect.") It is quite possible, as in the case of the Southeast Asia Venture Investment Corporation (SEAVIC), that venture capitalists, and others who seek involvement in the development of their area, will join in this intermediate financing institution. It is also highly disirable to include a U.S. bank with international experience in the financing consortium, and this inclusion seems to be reasonably possible.

Once this first step has been accomplished, AID has then acquired, through the local financing people, the capabilities of local staff that are familiar with the region. Through the American bank, it has acquired financial experience of presumably a broader and more sophisticated nature, as well as the experience of dealing in international projects with local financial institutions.

It will then be the responsibility of AID and the intermediate financial institution to find local entrepreneurs and U.S. corporations that will be willing to combine to produce a product or service needed in the country in question in such a way that they have the approval of the local government, as well as, of course, satisfying the requirements of AID. The U.S. company with the product know-how will tend to shape the business aspects of the project with the advice of the financing institutions and of the local entrepreneurs, where their experience would be appropriate. The responsibility to put the final deal together definitely does not rest in AID, but the arrangements should reflect AID's desired purpose. A responsibility to audit and monitor should rest in AID. This responsibility should be exercised with restraint, for the costs of a U.S. Government audit can be a heavy burden for the one audited.

Taking this approach has a number of benefits. It brings in accredited U.S. technology and accredited international financial experience. The involvement of the U.S. company, its investment of time and good name, as well as (presumably) some money, would indicate an experienced belief that the project has some reasonable chance of success. The inclusion of all of this expertise and money will benefit AID in a quite different way: AID funds would be leveraged to a considerable extent; therefore, a greatly increased number of projects is possible over what could be presumed from the size of the AID budget.

We must be prepared to see some of the projects fail. Fo such projects, besides the ordinary business risk, there is the additional risk of location. But it should be recognized that there is also the chance of winning, and winning big. We would suggest that AID take warrants, convertible debentures, or some such instruments as part of the paper it receives for its investment. Then, if the project is a substantial success, AID can capitalize on that success and cover the cost of other projects that have not done as well. One substantially successful project can often cover the losses taken in ten projects that fail in varying degress.

It would be desirable for each project to contain an Economic Impact Statement in its description. The statement should indicate what the economic impact is expected to be on the country in question and on the United States. In many cases, the impact on the United States will be quite positive at the very initiation of the project as machinery that is familiar to the U.S. investor is shipped from the United States. Other levels of impact will have less certainty, because they may depend on the success of the project, but even so, they could be estimated. These statements would be available to the Administration and to Congress, so that when

AID is reviewed in the future, they would become a part of the story. In one Task Force plenary session it was stated that these Economic Impact Statements belonged with investments that were made in potentially profit-making projects, but upon reflection, it seems appropriate to attach them to each AID project regardless of the character of the project, since there will certainly be an economic impact on at least the country involved.

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III.

TRADE

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6.

A STRATEGIC RESPONSE TO GLOBAL COMPETITION

By Harald Malmgren

A STRATEGIC RESPONSE TO GLOBAL COMPETITION

INTRODUCTION

Expansion of private enterprise activity and liberalization of world markets have been objectives of American policy for almost 50 years. In pursuit of these objectives it has been hoped that economic well-being of all peoples would be enhanced and that the adoption of more and more nations of economic and social philosophies based on liberal markets would lead to greater freedom and democratic participation in governance.

This thrust of American policy, as well as American competitiveness, is being challenged by government policies in many nations.

Governments throughout the world intervene heavily in trade by managing imports, promoting and assisting exports, and guiding domestic industrial, agricultural, and technological development in efforts to enhance their domestic and international competitiveness. The present worldwide trend is clearly toward growing intervention and widening management of trade by governments.

Interventionism is increasingly focused on commercial and investment relations with the developing world and with the nonmarket economies (China, Eastern Europe, and the Soviet Union). In recent years, a growing share of the total exports of the United States, Japan, and the European Economic Community (EEC) has been flowing to these markets. The developing world in particular has been perceived as the principal growth market in world trade; for decades trade with developing countries has grown relatively faster than trade among the industrialized nations.

Trade with the developing world and with the nonmarket economies requires special financing. The cumulative international debt pressures on these countries has accentuated the need for preferential credit and resource transfers. Such debt service pressures can be expected to continue at least throughout the 1980s and probably well into the 1990s.

From this perspective, a number of governments of the industrialized nations consider subsidized credit or preferential financing to be a natural, essential characteristic of trade relations with developing nations and with the principal nonmarket economies.

Therefore, soft credit is not solely justified by such governments as a weapon with which to beat the competition. Rather, soft credit is perceived as essential to trade expansion. It is perceived as a more or less permanent feature of trade relations between rich and poor and between hard currency countries of the West and other countries with weak or inconvertible currencies. The only alternative, in that perspective, would be a major expansion of bilateral and multilateral resource transfer directly, something that is politically impossible to achieve at this time in any Western industrialized nation. The prospects are therefore poor for eliminating all preferential trade credits through multilateral negotiation.

American policy should be devised in a long-term framework which recognizes the vital role of developing nations as markets, and therefore as trading partners. American policy should also be based on the assumption that preferential credit will be a continuing characteristic of other governments' policies for the foreseeable future, and that the scope of preferential credit is likely to expand to help offset the credit constraints imposed by cumulating international debt service pressures. Moreover, policy must be devised to deal with the reality that government intervention and management of world commerce is expanding, not contracting, and that competitiveness is being increasingly affected by government policies in both exporting and importing nations.

The Global Market

International trade functioned as a driving force in the world economy in the 1960s and early 1970s, growing at roughly double the rate of increase in world gross national product (GNP). This not only had the effect of interweaving more closely the economies of the industrialized, Western free market nations, but also of drawing the markets of the developing countries and of the developed world into a closer and more dynamic relationship. These latter ties were an especially strong element of world growth. It is not well known, for example, that in recent years U.S. and European Community exports to developing countries have been growing faster than to other markets, so that the share of their total exports destined for these Third World markets has recently been about 40 percent (as compared to around 30 percent in 1970), while more than half of all Japanese exports go to the Third World.

However, the rates of growth of world production and of world trade slowed down dramatically after the 1973 oil shock. World production grew at an average rate of 6 percent from 1963 to 1973, whereas it slowed to about 3 percent per year in the 1973-1981 period, and thereafter reached a stage of virtual stasis, or even slight decline. This slowdown in production was paralleled by a steady decline in the rate of growth of the volume of world exports, from 11 percent growth in the best recent year, 1976, to a standstill in 1980 and decline in

1981-1982. (In value terms, the level of world trade contracted in 1981, to about $1,970 billion, as compared to $1,985 billion in 1980, and contracted further in 1982 to about $1,850 billion)

The recent period of stasis and decline in world trade laster longer than any similar leveling out or contraction since the 1930s. Present indications suggest that very slight growth occurred in world trade in 1983 and only moderate growth can be expected in 1984.

The decade of the 1970s brought more than an increase in interdependence and a gradual deterioration of production and trade. It also brought a number of shocks to trade and capital investments. Among these were: the run-up of global inflation even before the 1973 oil embargo; the shift to fluctuating exchange rates after the August 1971 U.S. emergency economic measures and the December 1971 Smithsonian Agreement; the emergence of the newly industrialized countries as serious competitors; increased volatility of commodity prices and supplies of foodstuffs; increased government intervention in shaping and assisting the development of key industrial sectors; and the spread of trade restrictions and subsidies.

This period of dramatically changing price relationships and emergence of new competitors demanded a more rapid adjustment of national economic structures, but instead the shocks, uncertainties, and volatility of markets had a dampening effect on long-term capital spending. Economic malaise in key industries drew governments into a more active role, intervening in key industries to assist and cushion them. But the increase in government intervention has often had the effect of postponing problems and retarding adjustment domestically, while distorting international conditions of competition.

Role of Developing Countries in World Demand

In analyzing the elements of strength in world trade in recent years, the General Agreement on Tariffs and Trade (GATT) secretariat has observed that world exports of agricultural and manufactured products continued to grow in the late 1970s and early 1980s, albeit slowly, but that most of the additional import demand came from outside the industrial areas: for example, 45 percent of the 1981 increase in volume of manufactured exports was accounted for by growth of exports from industrialized nations to oil-exporting developing nations; 15 percent by industrial countries' exports to other developing countries; and 10 percent was due to expansion of trade among the developing countries themselves. The increment of growth in manufactured exports in trade between the Western industrialized nations was only 5 percent.

This important role of developing country markets was first dramatized during the 1974-1975 global recession. A combination of oil-generated foreign exchange surpluses enjoyed by the oil-exporting nations and escalated international borrowing by the non-oil-developing nations helped cushion the world downturn. Although the volume of world trade contracted in every other area, the volume of exports to the developing world increased.

It is doubtful, however, whether the developing countries can play the same role as a major source of world import demand in the next few years without special financial measures.

First, the heavy borrowing of the non-oil-developing countries in the 1970s, combined with high interest rates and economic stasis, have resulted in a debt pile-up which will take several years to work off. Both the Internatinal Monetary Fund (IMF) and major international commercial lenders are counseling the high debt nations to adopt internal austerity programs and to curtail imports and boost exports. The oil-exporting developing nations are also once again experiencing diminishing current account surpluses. The consequence has not only been a sharp deterioration in growth of exports of manufactures to both these groups of countries, but also a dramatic fall-off in the longer-term turnkey projects aimed at development of energy, resources, and industry in these countries.

Second, the availability of finance for the non-oil-exporting developing nations became constrained by two sets of forces: official multilateral and bilateral development assistance flows are being curbed by budget limitations in the donor countries; and commercial banks are slowing down the pace of their lending to high debt countries. The caution of commercial banks is in turn motivated by a variety of considerations: withdrawal of relatively smaller banks from international syndications; regulatory limitations on concentration of overseas lending exposure; prudential reassessments of credit-worthiness; and significant domestic lending problems with non-performing debt and financial failures in the home markets of the major international lenders.

Third, the developing countries are all simultaneously trying to stimulate exports and limit imports. This puts constraints on the potential for growth in their trade with each other. It also intensifies world market competition for the products they wish to sell, since each is to a significant extent trying to sell similar goods, both in resources and in labor-intensive manufactures.

Fourth, the pervasive weakness of commodity markets and the constraints of debt service obligations are encouraging many governments and enterprises to resort to complex barter arrangements. Oil, rubber, phosphates, timber, coal, semiprocessed nonferrous metals, and other such products are being offered in exchange for tractors, machinery, ships, and even aircraft. This growth in nonmarket transactions coincides with an expansion of barter, buy-back, and offset arrangements between the Western industrial nations and the Soviet Bloc. The result in some cases is to intensify downward price pressures on commercial exports of such goods from the developing world.

Fifth, protectionism in the industrialized countries against imports from the developing world is clearly intensifying and expanding. For example, the EEC and the United States are currently seeking rollbacks and slower future growth rates for imports of textiles and apparel from developing country suppliers. A gradual increase in bilateral undertakings to restrict exports of manufactures to a number of European nations has been taking place, sometimes on the basis of industry-to-industry talks sanctioned by governments and at other times in more formal undertakings by governments. In the United States, a build-up of sentiment is taking place against imports of processed raw materials and manufactures produced on the basis of artificially cheap energy and official aids and incentives, which are prevalent in the industrial policies of key developing nations.

Sixth, the turbulence in the economic conditions of some developing countries, together with erratic industrial policies and treatment of foreign investment (e.g., Mexico and Brazil) has encouraged many multinational enterprises to reconsider their investment strategies and to postpone new investments in developing nations.

The Potential Impact of Protectionism and Nationalistic Economic Policies

Import restrictions are expanding in scope and magnitude in both industrialized and developing nations. The director of economic research of the GATT secretariat, Jan Tumlir, recently estimated that the share of total world trade now constrained by nontariff trade restrictions is between 40 and 48 percent. Moreover, his estimates suggest that this share has grown significantly since 1973.

Quantifying the scope and effects of new forms of protection is very difficult. As tariffs have been brought down in the successive rounds of world trade negotiations since the late 1940s, the role of nontariff measures that limit or distort trade and investment has become more important. These nontariff measures often involve broad administrative latitude in their implementation. There are many kinds of official policies, measures, and even attitudes, which are explicitly aimed at limiting imports, and relatively easy to identify, but difficult to evaluate, such as:

o official guidance to harass or impede imports, through administrative procedures involving documentation, inspection, valuation, etc.;

o official tolerance, or even approval of industry-to-industry talks on export limitations and division of markets;

o allocation of import licenses to enterprises that intentionally fail to use them, or that buy from designated suppliers in preferred countries of origin;

o establishment (especially by Japan) of export cartels to raise prices of exports, in order to limit the volume of exports and to reduce the downward price pressures in importing countries, usually at the request of governments or industries of the importing countries;

o so-called voluntary restraint agreements (VRAs) negotiated bilaterally between governments of the importing and exporting nations in question;

o restrictive business arrangements for wholesaling and distribution which limit marketing and cause high markups for imports, often sanctioned by governments; and

o "buy national" policies.

These types of measures discriminate against imports. Another array of trade-distorting measures can be found in domestic industrial, agricultural, and regional development policies:

o subsidies, tax incentives, official loan guarantees, equity participation by state holding companies, etc., which are used to encourage establishment of import-substitution industries, to sustain production facilities which are inefficient by world market standards, and to promote exports;

o performance requirements established as a prerequisite for approval of foreign direct investment proposals, involving private enterprise commitments to export a specified share of production, to maintain a specified level of domestic value-added and labor content, to use local banks and other suppliers of services, and to promote local technological capabilities through specified technology transfer arrangements and establishment of local R&D facilities; and o official assistance for "targeted" technologies and enterprises for the development and commercial exploitation of indigenous technologies, often in combination with officially encouraged interfirm R&D cooperation, and official guidance of mergers and overall concentration levels.

These types of sectoral intervention measures can be found not only in the developing countries, but also in Japan, Canada, and European nations. There has been an increase in the scope and magnitude of such intervention in recent years and this is giving rise to increasing complaints from private businesses, especially in the United States, about "unfair competition." The U.S. Government has sought to begin a process of international scrutiny of such measures in the GATT and in the Organization for Economic and Community Development (OECD), with a view to reducing the level and scope of state intervention in key sectors. However, many governments believe that such forms of intervention are necessary to guide industrial and agricultural modernization and reorientation and assure national autonomy, especially in countries with markets which are far smaller than that of the United States and which fear "dependence" on U.S. business decisions and U.S. Government policies.

Moreover, many governments believe that the level and scope of such intervention will most likely increase in the next few years, in response to growing unemployment and what they perceive as structural economic problems.

For example, European governments foresee a trend of rising unemployment in the mid-1980s as a result of a number of convergent forces. The baby boom came later in the EEC than in North America, which is still causing a rapid increase in new entrants to the labor force in Europe.

Moreover, there is considerable pessimism in European governments about the long-term competitive outlook for the so-called smokestack industries (e.g., steel, nonferrous metals, chemicals, and petrochemicals). How best to cope with the perceived need for scaling back and restructuring these key sectors is subject to considerable controversy within the EEC. Nonetheless, there is a growing sentiment in business and official circles in the EEC that official coordination of the plans and activities of enterprises in the most troubled sectors, in the framework of so-called recession cartels, may be necessary. The Davignon Plan for the EEC steel industry is one example, and there is currently growing support for a similar approach in the European petrochemicals sector. There is particular concern over the potential competition from newly industrialized countries (NICs) in sectors already characterized by excess capacity.

Therefore, a likely scenario for the smokestack industries in the 1980s is an expanding role of governments domestically and internationally, including official management of the volume and direction of trade in these sectors.

Where national industrial, agricultural, energy and technological policies constitute an important factor in export competitiveness, countermeasures to limit imports in the importing countries are likely in the next few years. Such countermeasures, especially through antidumping and countervailing duty actions, have not had a major impact on trade flows in the past, but they can be expected to have growing effect in the mid-1980s, with particular impact on developing country exports.

To summarize, the prolonged period of world economic stasis and the likelihood of slower growth in the next few years than the growth rates prior to the 1973 oil shock will tend to encourage widening use of import restrictions and aids to exports and will also tend to increase the degree of sectoral intervention by all governments. These tendencies, especially toward sectoral intervention domestically, are in turn likely to encourage use of countermeasures by importing countries to offset what are believed to be unfair distortions in competition.

American Policy Trends

The international economic policies of the United States have continued to be oriented toward liberalization of world markets and scaling back of government management of trade and investment globally. The means to achieve these objectives have varied, including:

- multilateral negotiations in the GATT to reduce tariffs and nontariff distortions to trade, including negotiation of "codes" which cover government subsidization and other forms of direct intervention;

- multilateral negotiations in the OECD to limit government-assisted export credits and related official export aids;

- threats of retaliation, and specific countermeasures devised to offset official support provided to competitors, through "flexible" Exim-Bank policies and agricultural export subsidies; and

- attempts to coordinate development assistance policies of the Western industrialized countries, especially through the Development Assistance Committee (DAC) of the OECD.

These policies and the international negotiating processes for carrying them out have had considerable success. The relatively fast growth of world trade and the internationalization of world trade capital markets in the last 40 years or so are evidence of that success.

Nontheless, new challenges have been imposed in recent years by the shocks of the 1970s, slower growth, debt service difficulties of developing countries, expanding government intervention in world commerce, and exchange rate difficulties caused by differing mixes of monetary and fiscal policy in the major countries as well as by capital flight to the "safe haven" of America. One consequence has been the emergence of a massive U.S. trade deficit in 1983 and 1984.

American responses to the changing economic forces of the 1970s and 1980s have often been inadequate, untimely, even counterproductive. Disincentives to trade emerged as the result of policies which gave inadequate recognition to the global competitive environment and increased efforts by other governments to cope with the turbulence of the 1970s and early 1980s.

A separate paper prepared for the Task Force by Michael J. Calhoun outlines the policy impediments to U.S. competitiveness in exports. In that paper, it is pointed out that American firms expect the American Government to act as an overseer of their commercial interests in dealings with other governments, precisely because of the growing role of other governments in the conditions of competition.

Yet the U.S. Government has demonstrated an ambivalence toward these international trends, with import problems gaining far more policy attention because of their disturbing or disruptive affects on the domestic status quo. Government policies, primarily focused on domestic issues, have lagged behind the growing internationalization of the American economy. Where we have "internationalized" an economic policy, it has often been a matter of extraterritorial extension of U.S. policies and laws to other nations (e.g., antitrust, financial regulation, export controls, deregulation of transportation, etc.), thus creating policy conflicts and economic tensions with other governments.

Disincentives to expanded trade and investment have arisen from:

o uncertainties generated by arratic reversals and adjustments in economic policies, based on political and national security considerations (particularly with regard to export controls); and o legislative, regulatory, and administrative restrictions and frustrations that deter or discourage exports and international business.

As regards the second category, there have been gradual improvements since President Carter in 1978 directed all executive branch agencies "to take into account and weigh as a factor, the possible adverse effects on our trade balance of their major administrative and regulatory actions that have significant export consequence." Adherence to this specific directive was modest at best, but there ensued other legislative and regulatory changes that have resulted in improvements. Occupational Safety and Health Act requirements, Consumer Products Safety Commission standards, and Environmental Protection Act conditions, which at one stage imposed standards higher than those imposed on foreign competition, are no longer considered by American business as significant disadvantages. Human rights-related restrictions are less problematic now in normal commercial transactions. The various "antiboycott" regulations under the Export Administration Act, Department of Commerce Regulations, and the Tax Reform Act of 1976 are still considered major administrative nuisances, but businesses feel they are less troublesome and applied more sensitively today than five years ago. Improvements have been made in tax policies, particularly regarding taxation of business representatives and staff residing in other nations.

There are, however, continuing discouragements and disincentives built into other policies. The Foreign Corrupt Practices Act, sometimes referred to as the antibribery law, is one frequently criticized by business. Other criticisms apply to antitrust laws, export control laws and administrative practices, and the scope of, and administrative access to, official credits for export.

By far the most important disincentive effects to trade emanate, however, from overall national economic policies, which only occasionally take into account international consequences. The most prominent example is the present mix of fiscal and monetary policies and the consequent effect in an overvalued dollar. Other policy mixes that are notable in this regard are tax policies that provide a strong bias toward current consumption as compared with savings and large federal budget deficits, thereby constraining availability of capital for private investment in productivity improvement and restructuring of industry, agriculture, and services.

The new challenges posed by expanding economic intervention of other governments are not being addressed in any coherent manner. New multilateral negotiations for the 1980s are now being contemplated by the Executive Branch to deal with these challenges, but such international negotiations will take many years, and their effects will therefore not be felt until well into the 1990s.

For the intervening years, there is clear need for policy change and focus to counteract, or at least cope with, the expanding role of foreign governments in determining the conditions of global competition. This is especially important in the area of official financial support of international businss activity, an area in which other governments provide relatively greater assistance and are often more aggressive in support of export sales.

Competition from Western Industrialized Nations

As noted in the introduction, in recent years the major growth markets for world business have been the developing countries (and nonmarket economies like China). Over half of total Japanese exports, and about 40 percent of U.S. and EEC exports, have been destined for developing country markets.

However, because of the world debt crisis, sales to such countries are increasingly dependent on the terms of financing from the highly industrialized nations. Imports into debtor countries are being severely constrained by limitations on availability of private lending and public sources of finance.

Because of the vital importance of these markets, most governments (even including developing country governments) have been increasing their official efforts to assist or promote exports to developing countries.

In particular, official financing of trade is being expanded. In 1981, the percent of the major trading nations' total exports supported by offical finance was as follows:

United States	5.8%
West Germany	9.1
France	26.6
United Kingdom	32.4
Japan	37.1

While each of the governments of the Western industrialized nations provides financial and other forms of support for exports, the specific techniques vary from one country to another. These variations reflect national differences in the institutional structure of governments, and in the relationships of governments to banks and other financial institutions. In France, for example, the government owns the banking industry and dominates the capital market and can therefore allocate capital much more easily than in other nations. In Japan, the government can also exercise great influence over capital flows because of the partial insulation of the yen market from international market forces and because of the strong effects on financial markets of the guidance role played by the Ministry of Finance and the Bank of Japan.

In contrast to the United States, Canada, or the United Kingdom, it is relatively easy in France and Japan to bring about close coordination of private banks, private trading enterprises, and government agencies in making large-scale sales to developing countries or to Eastern Europe. In France, coordination is centralized in one agency, the Ministry of Finance. In Japan, official responsibilities are diffused among a number of agencies, such as the Overseas Economic Cooperation Fund, the Export Insurance Division of MITI, the Export-Import Bank of Japan, the Ministry of Finance, and the Ministry of Foreign Affairs. Nonetheless, with respect to sales to developing countries and to nonmarket economies, the various Japanese agencies work in close coordination with each other and with private enterprises and financial institutions.

It is relatively easy in Japan to link development assistance grants and loans to more specific support of sales of projects. For example, the Japanese government has recently been providing a series of very soft-term development assistance loans to the People's Republic of China and these loans have "encouraged" resumption of such projects as the Baoshan steel complex being built by Japanese contractors.

In France, it is possible to draw together, at the Ministry of Finance, one consortium of all the potential contractors and lenders that might be involved in sale of a turnkey project in, say, North Africa or Francophone West Africa. Designation of "chosen" participants, their respective roles, and the forms of finance flowing to each is then possible. A minister and a key official of a lead company or bank can then talk as a team to a foreign buyer, such as a government in a developing country, and offer one-stop shopping: feasibility, design, construction, supply, technical support, management, and all necessary forms of finance (short-term, long-term, and even local cost financing).

The British and Canadians have specifically designated a certain part of their development assistance budgets for trade promotion. Other Western governments have improvised according to the particular market, the industrial sector affected, and the general level of their own domestic economic activity.

The United States Government has focused in the OECD its efforts to constrain official credits (with reliance also on the Berne Union). A series of undertakings have been negotiated among the Western industrialized countries which provide limits or guidelines for official support of exports.

There have been conspicuous omissions of coverage of certain sectors in these undertakings (such as aircraft and nuclear power projects), but on the whole there has been a moderate constraining influence.

However, the strength of the OECD undertakings and their actual scope of application have been diminished by many innovations in national policies, including the "mixing" of various forms of public and private credits. No significant effort has ever been made to bring together under one framework the GATT restraints and penalties applicable to export subsidies, and the OECD guidelines on official credits. Consequently, the OECD guidelines rely on voluntary cooperations, and transparency of public assistance programs, both of which are highly questionable.

When Treasury Secretary Donald Regan explained new guidelines which took effect in the OECD on October 15, 1983, he said then new guidelines would "virtually eliminate direct interest rate subsidies in official credits to the industrialized countries and significantly reduce the subsidy to the developing countries, by linking these rates to market interest rate movements, a long-sought goal of the United States."

The basic concept of the new undertakings is that the minimum interest rates permitted for official export financing in each country will now be adjusted automatically every six months to reflect changes in market rates. There will in this framework be differential "commercial benchmark interest rates" for several currencies, especially for the Japanese yen, the German mark, and the Swiss franc.

While this shift no doubt has some positive effects, it does not eliminate mixed credit practices and other supportive devices--and probably even encourages governments to expand their efforts in this direction. In conclusion, the OECD approach is far too narrow in focus, and the advances in that framework are simply not keeping pace with the innovations in national policies and programs to support exports.

France, Germany, Japan, Canada, and the United Kingdom all have programs for providing mixed credits, based on tied aid. A number of key competitors of the United States also provide, in addition to mixed credits, other instruments of support for long-term export transactions, including:

o <u>inflation risk insurance</u>, which is aimed at protecting exporters against losses resulting from domestic increases for projects or equipment dependent on lengthy fabrication periods (France and the United Kingdom);

o *exchange risk insurance*, which covers exporters against depreciation of foreign currencies when payment is denominated in such currencies (France, Germany, Japan, and the United Kingdom);

o *local cost support*, in the form of credits or guarantees for costs incurred locally in the purchasing country, in conjunction with export transactions (France, Germany, Japan, and the United Kingdom); and

o *foreign currency loans* for export transactions (France, and the United Kingdom).

The United States has responded with very modest support of local costs on certain occasions, but has not been able to match other foreign programs of the types listed here.

In the medium-term lending area, the OECD constraints are more effective, but the global market conditions are gradually eroding the distinctions between medium-term and long-term.

Trends in National Programs and Policies

Canada. The Canadian Export Development Corporation (EDC) operates within a policy framework of conducting operations on a financially self-sustaining basis, which in turn means acting closely in accord with commercial market practices. Canadian exporters have often criticized the EDC for taking on business which would otherwise have been readily handled by commercial banks, while failing to provide more innovative financial support the commercial banks would not be willing to provide. The commercial market practices which are supposed to guide the EDC and the reliance of EDC on funds raised in commercial markets are said to preclude a more innovative, subsidized approach.

The EDC tries to compensate with an elaborate array of insurance and guaranties; a forfeiting program (EDC purchases bank-guaranteed notes payable by foreign buyers to Canadian exporters, providing exporters cash for their receivable); unpublicized "matching" of foreign offers; and direct lines of credit to foreign banks and to foreign public and pri ate purchasers.

Continued criticism of EDC by Canadian exporters has encouraged establishment of a mixed credit program, through the setting aside of some development assistance funds for use in conjunction with EDC and commercial bank credits, and exploration of possibilities for wider use of "tied aid."

Occasionally, the Canadian Government is particularly aggressive in seeking particular export sales, such as in the recent controversial sale of passenger cars for the New York transit system. Canadian officials may also work directly with particular sellers by using diplomatic leverage to secure sales.

France. The French system is probably the most innovative and aggressive export assistance program. Official export credit policy and direct government support activities are centralized under the Direction des Relations Economiques Exterieur (DREE). The Minister of Trade and the Minister of Finance provide political-level guidance in theory, but in practice the Minister of Trade is more junior than the Minister of Finance. Moreover, the DREE has traditionally been part of the Ministry of Finance and is generally staffed with civil servants from the Finance Ministry. DREE has ultimate authority in most cases and can link its decisions to overall trade policy (DREE is responsible for French trade policy) and overall financial policy (through the Finance Ministry's role).

Three agencies carry out DREE policy: (1) Banque Française du Commerce Exterieur (BFCE), which finances latter maturities of long-term credits through loans or by discounting export credits extended by banks. (2) Banque de France (the Central Bank of France), which provides discounting for export credits with generous repayment terms of 18 months to 7 years. (3) the Compagnié Financiere de la Cote d'Ivoire (COFACE), which provides a wide range of credits, insurance, and guaranties for both commercial and political risks.

The types of insurance offered by COFACE varies somewhat according to categories: heavy capital goods and project financing with terms of five years or more (commercial risk cover on supplier credits varies from 80 to 85 percent of the financed amount; political cover on supplier credits is 90 percent; and cover on buyer credits is 95 percent for all risks); light capital goods with repayment under 5 years (commercial cover is 85 to 90 percent, and political cover is 90 percent); export of consumer goods, raw materials, and equipment with maturities varying up to two years (with commercial and political risk cover to 90 percent). COFACE premiums vary, and are composed of visible, published rates combined with specific, negotiated premiums that are set and then worked into the final contract price, but not disclosed publicly.

BFCE and the Central Bank provide necessary support for financing at OECD minimum rates. Beyond this, mixed credits are used extensively to provide a strong competitive edge. Mixed credits may be based on a combination of Treasury loans, grants on highly concessional terms, and government-guaranteed export credits at the published OECD minimums. The characteristics of a credit package often are an unusually low rate of interest, long repayment periods, and a grace period before any payments come due. To distinguish between development assistance and trade credits in France is difficult, because the policy process improvises, and the published statistics reveal little of the underlying rationale or the commitments actually related to particular sales.

Other types of "insurance" are often offered to assist further France's exporters, including exchange risk insurance, contract guaranties, and performance and bid bonds.

Above all, the DREE works with the key government bodies, the commercial banks, and the potential sellers to organize the most effective package, and lends strong diplomatic support and broader offers of economic cooperation and development assistance to secure sales to developing countries.

Japan. The major agencies which provide official export support in Japan are: (1) Export Insurance Division (EID) of the Ministry of International Trade and Industry; (2) Export-Import Bank of Japan; (3) Overseas Economic Cooperation Fund (OECF); and (4) Bank of Japan.

Programs offered include buyer credits and foreign bank credits as well as supplier credit; fixed rate financing; commercial and political risk insurance; exchange risk insurance; performance and bid bond guaranties; local cost financing; "parallel" financing; and mixed credits (with OECF). In addition, the Export-Import Bank provides import credits for imports of resources and raw materials (thus encouraging the financing and development of mining and other resource projects in other nations); direct loans to foreign governments and financial institutions to fund major development projects, especially in energy; direct investment loans to foreign governments to support joint ventures with Japanese companies in these countries; and other forms of overseas project loans to Japanese corporations, intended to assist in establishment of these firms in foreign countries.

The Bank of Japan offers limited discounting of short-term export credits.

The interaction of officially supported export credits and development assistance with Japanese long-term import policies (development of import supplies of energy, food, and other resources) facilitates flexible and responsible practices in support of particular overseas projects. The agencies cooperate rather closely with each other, and with commercial banks and trading companies (Japanese trading companies borrow on a very large scale for their own account and then lend funds for international transactions including transactions related to turnkey projects and sales of capital equipment).

As in France, the close relationship of government to the commercial banking sector of Japan provides great flexibility in achieving desired export results. Moreover, Japanese officials may assist, diplomatically and in other ways, selected companies with regard to particular overseas projects.

United Kingdom. In the United Kingdom, official support for exports is centralized in the Department of Industry and Trade, and in the Export Credits Guarantee Department (ECGD), but there is also a mixed credit program involving 10 percent of all development assistance funds, over which the Department of Industry and Trade (under the Minister for Trade) has authority.

ECGD offers both comprehensive and specific insurance policies for exports and overseas risks; bank guaranties for short-, medium-, and long-term credits; cost escalation insurance; performance and bid bond insurance interest subsidies for medium- and long-term transactions; and mixed credits.

The ECGD operates essentially on two accounts. The Commercial Account provides "purely commercial" cover for about 89 percent of its total insurance and the National Interest Account provides cover for transactions on noncommercial or preferential terms.

Bank guaranties of up to 100 percent are liberally provided and commercial and political risk insurance cover are in the 90 to 95 percent range.

The ECGD offers financing for both supplier and buyer credits, in U.S. dollars, deutsche marks, and pounds sterling.

Because of budgetary pressures domestically and changing forms of competition in external markets, the role of ECGD has recently been under intensive review, particularly as regards its insurance programs. Nonetheless, much of its preferential insurance would not be readily commercialized, and it is doubtful whether the present review will drastically alter policies.

The Department of Industry and Trade is prepared to work closely with British firms and banks in the selling of major projects and will actively support project consortia with diplomatic steps and general policy adjustments. The Minister of Trade is expected to act as a super-salesman for British exporters.

West Germany. The German programs are more market-oriented than those of other Western European countries. Nonetheless, programs include not only direct credit support, but also commercial and political risk guarantees for short-, medium-, and long-term financing; local cost insurance; exchange risk insurance; performance and bid bond insurance; and mixed credit financing.

HERMES operates as a quasi-government private company, acting on behalf of the government, and provides short-, medium-, and long-term insurance cover for commercial and political risks, local cost insurance, foreign exchange risk insurance, and bond insurance.

Export credits are provided by AKA, a private company owned by 56 German banks, which has access to rediscounting by the Deutsche Bundesbank (the Central Bank) and by KfW, which is a government institution jointly owned by the Federal Government and by the state governments. AKA and KfW require HERMES guarantees and other forms of insurance.

Mixed credits are established by combining KfW funds and development assistance funds from German aid programs.

The main thrust of much of Germany's programs is to encourage exports to relatively higher risk markets, particularly developing countries and nonmarket economies of Eastern Europe. Its programs are therefore more focused than American Exim-Bank activities and comparisons have to take this into account.

German diplomatic efforts will often be made on behalf of particular consortia that are seeking sales in overseas markets. The Economics Minister and Finance Minister often bring business representatives on trips to key countries to combine bilateral policy discussions with increased German exports.

New Competition from Third World Suppliers

Governments of developing countries are also becoming highly innovative in their arrangements for financing imports and exports.

Many of these countries have unrealistic exchange rates, but devaluation is often delayed as long as possible because of the domestic inflationary effects. Consequently, many developing nations have intricate export incentives or subsidies, domestic aids to industry designed to enhance international competitiveness, and unusual exchange rate systems that provide, de facto, multiple exchange rates.

A number of the NICs are becoming major competitors of U.S., Japanese, and European enterprises in several major sectors (for example, textiles and apparel; footwear and leather products; consumer electronics; aircraft such as commuter planes, executive jets, and small turboprop planes; shipbuilding; steel production; machine tools; and engineering services). The NICs are under continuing competitive pressure, and debt service pressure, to strengthen exports. They can be expected to absorb current production and product technologies from industrialized nations, and expand production and export of many other manufactures, incuding capital goods.

Governments of these countries are also providing special forms of official financing for exports, as well as negotiating elaborate barter or countertrade arrangements to facilitate export sales and secure essential imports. For example, financing terms for American business purchases of Embraer aircraft (Bandeirante; 1984 commuter aircraft) have been more favorable than for competing aircraft produced in the United States, Canada, or Western Europe.

The nonmarket economies are also trying to develop elaborate mechanisms for limiting imports and boosting exports. One approach is widespread use of barter and countertrade. A second is highly intricate pricing and incentive schemes geared to exportation (e.g., Hungary). A third approach is to utilize multiple exchange rates and special export taxes.

PRC: A Special Case

The PRC maintains an elaborate system of countertrade, multiple exchange rates, and varying export taxes. This system is designed to limit imports of goods which might compete with domestic source goods; facilitate imports of food, raw materials, and imports needed in the manufacture of exports; and promote exports of manufactured goods destined for hard currency markets.

At the beginning for the 1980s, it appeared to be necessary to offer substantial credit on very soft terms if exports to the PRC were to be made. Since the introduction in 1981 of the current PRC multiple exchange rate system, however, the picture has changed dramatically. The PRC has generated substantial trade surpluses and reserves.

Nonetheless, most Western industrialized nations competing for business in the PRC are still offering substantial official credits, some of it on very soft terms. Japan, in particular, has been willing to offer aid funds "in association with" development of turnkey projects.

Trading with the PRC therefore requires a new strategy, which takes into account: (1) the extraordinary exchange rate system; (2) the preferential financing necessary; and (3) the long-term market potential.

Changing Market Requirements

The responses of governments to each other's policies and to changing market needs causes a continuous evolution of government practices and competitive circumstances.

One recent example is the agreement by several governments to provide open lines of official export credit to Brazil as part of the late 1983 Brazil "rescue package" (the Exim-Bank of the United States provided $1.5 billion in an open line of credit in this connection). Expanded use of such unspecified buyers' credits may be essential to maintain exports to high debt countries during periodic cash flow crises that they may be expected to experience.

The evolving character of commercial relationships between the multinational enterprises and the developing countries provides another example of fundamental change. Major resource-related multinational companies increasingly operate on the basis of minority equity positions or even without direct investment in resource development projects, placing greater commercial emphasis on earnings from fees for feasibility, design, engineering, and management services, as well as on trading operations and financing. Manufacturing companies are also improvising more and more in their relations with developing countries, as a response to performance requirements imposed by governments in those countries, as well as in response to the recent corporate objectives of lowering direct investment exposure or risk in high-risk locations (particularly in high-debt or politically turbulent developing nations).

Smaller companies attempting to enter export markets are increasingly finding that provision of feasibility, design, engineering, and operating services are vital to sales of goods.

In general, the American Government has not been generous in the provision of assistance for services, even when related to potential sale of goods. Thus, the more up-to-date way to compete in many markets would be to enter a contract to provide feasibility studies, engineering services, training, financial and operating management, and perhaps marketing or trading services. Payments for training and engineering might embody payments for technology transfer. These new ways of doing business require revision in the government agencies' definition of what constitutes an export "sale."

The OPIC, AID, and Exim-Bank provide few programs aimed at these new forms of international competition, even though such activities would normally generate export sales of some equipment and industrial inputs and would tend to link the developing country markets with U.S. suppliers over the long run.

Other governments have been more alert to the shifting requirements of buyers and sellers. For example, Italy recently signed a technical assistance agreement with China establishing a three-year program covering 40 projects. Details of each project will be examined at a subsequent date, and funding of the projects themselves, separate from the technical assistance element, is expected to follow. (This July 1982 technical assistance agreement authorizes expenditures of about $30 million of grant aid for feasibility studies, training, and provision of experts; in addition, the Italian government earmarked $165 million in soft loans at 2.25 percent interest, repayable in 13 years with a two-year grace perid, for general support of projects emanating from the technical assistance contract.)

"One-stop shopping" is a trend in buyers' behavior that can be expected to continue. Since buyers increasingly want services linked to goods, and multinational sellers are increasingly interested in providing services and goods without direct investment commitments, there is a mutually reinforcing thrust in shifting the characteristics of commercial relationships with major buying nations.

Thus, American export policy should be revised to reflect the convergence of services and goods transactions, and far greater emphasis should be given to official support of exports of services.

Mixed Credit Strategies

The term "mixed credits" implies use of one or more forms of soft or subsidized credit in conjunction to create blended terms which are more favorable than credits on commercial or near-commercial terms. Such blending can also include commercial credits.

Sometimes the term "mixed credits" is used simply to denote a combination of aid with commercial or near-commercial credits. In such cases, the aid funding on highly concessional terms is tied to purchases in the donor country. The mixed credit result usually has both a low effective interest rate and preferential grace and repayment periods. However, the linkage of aid and commercial credits constitutes too narrow a definition. In practice, the blending of credits to achieve special terms may encompass a considerable number of public and private instruments including: soft aid; technically unrelated government assistance (such as military assistance); Exim-Bank-type credits; other government-assisted credits (e.g., agricultural export aids like Commodity Credit Corporation, P.L. 480); government guarantees; government insurance of risk, inflation, and performance; government-assisted "market development"; private commercial credits and insurance; and government-private programs (such as government discounting of bank paper). The blended credit package may combine long-term and short-term credits in such a way as to provide unusually competitive terms.

Governments theoretically should report to each other those export assistance packages that are unusually favorable, but there are few real incentives to reveal the true details of a winning package, and the complexity of arrangements makes obscurity in reporting, or nonreporting, rather easy.

Consider first the distinction between foreign aid and export credits. Foreign aid, or official development assistance (ODA) is defined by the Development Assistance Committee of the OECD as funding which embodies a grant element of at least 25 percent, and serves "development purposes." The participating governments in the OECD undertakings have agreed not to offer mixed credits with a grant element less than 20 percent; to notify in advance other participating governments of credits with grant elements of 20 to 25 percent; and to classify grant elements over 25 percent as ODA and to report such credits after completion of agreements. In practice, the level and quality of OECD mutual reporting is poor with reports which are very obscure about the scale, terms, and even products covered in mixed credit arrangements.

Often, a small increase in the ODA or aid element allows a credit package to be classified as foreign aid, with less mutual scrutiny as to the precise national export impact.

However, some governments take a far more sophisticated approach in providing mixed credits without attracting attention or criticism of other nations. For example, blending of credits may be achieved in ways that are not readily transparent to outside parties that are not participants in a particular package.

o One method is to disaggregate a single, large-scale project, turnkey project, or commodity sale into components, providing special financing, guarantees, or insurance for some components of the transaction, but leaving other components to be handled by the market or by official export credit support within the OECD guidelines.

o Another method is to agree to provide general development assistance in a non-earmarked form parallel with, but not formally inked to, a project or set of transactions financed with commercial or official export credit support.

o A third method is cofinancing, with public funds used to soften the overall credit terms and generate greater private financial support at the same time.

American Responses

The U.S. Government response to mixed credit export competition has so far been limited to:

o efforts to negotiate further limitations under the OECD framework;

o threats of retaliation, through the establishment of a "war chest" to meet and beat subsidized foreign bids;

o stretching of Exim-Bank terms in targeted markets (e.g., Francophone North Africa) to win selected bids; and

o establishment in AID of a mixed credit facility, the Trade Financing Facility (TFF), which in practice has applied to Egypt only and is not significant in effect.

As noted earlier, the OECD negotiating framework has proved to be too narrow, and the results have had limited real impact, except perhaps to encourage greater use of mixed credits.

Retaliation, through establishment of a "war chest" based on congressionally appropriated funds, might win bids but would not necessarily drive other governments to the negotiating table. A number of other governments, as noted earlier, believe that below-market terms are essential to sales to developing countries, and that such countries deserve preferential financing. Moreover, this is one way to continue to obtain parliamentary support in other nations for resource transfers to developing nations, inasmuch as exports are strengthened and domestic jobs are increased.

Moreover, a number of other OECD member governments believe the United States is presently far too restrictive in its provision of bilateral and multilateral development assistance. Consequently, an increase in soft credits from the United States in any other form might be welcomed on the theory that any incremental resource transfers are good for development. In turn, cash-short developing countries suffering from debt service constraints, that have already cut imports "to the bone," would be able to expand imports and step up development generally. This, it can be reasoned, would eventually result in a higher growth rate in those developing countries, and in turn higher purchases by them of exports from the hard-currency OECD nations as a whole.

The selective Exim-Bank responses in targeted markets have succeeded in winning sales on some occasions, but their lasting effect must be considered nominal. Without special, additional resources, this effort is limited by Exim-Bank's operating requirements, and these limitations are well understood by government agencies in competitor countries.

The TFF cannot be effective for simple reasons. Under TFF, U.S. exporters who would be competitive, except for subsidized financing offered by other nations, may apply for a TFF grant. Such a grant could be designed to neutralize the foreign credit differential. However, the TFF funds come from existing Economic Support Fund (ESF) commitments. Therefore, the purchasing government has no incentive to accept the TFF supported bid. On the contrary, soft credits from non-U.S. sources would constitute incremental resource transfer, whereas the U.S. soft credits would simply amount to a transfer from alternative projects that would otherwise be funded by ESF. Moreover, TFF is authorized only in response to a proven, existing offer already made by a competitor. By the time TFF could be approved (including collection of data on foreign bids and demonstration of its consistency with "development needs"), the bid would likely have been lost.

The Eximbank-AID Mixed Credit Program

The U.S. Congress has been increasingly interested in the problem of meeting or counteracting the use of mixed credits and other forms of subsidized export credits.

In amendments to the Domestic Housing and International Recovery and Financial Stability Act (passed on November 18, 1983), the Congress stipulated certain changes in Exim-Bank authorities and practices. Among these was establishment of a Tied Aid Credit Export Subsidies program authorizing: (1) combined use of credits, loans, or guarantees offered by Exim-Bank with concessional financing or grants offered by AID; and (2) combined use of credits, loans, or guaranties offered by Exim-Bank, or by AID, with financing offered by private financial institutions. The purpose of this authority to blend credits is "to offer or arrange for financing for the export of United States goods and services which is substantially as concessional as foreign financing for which there is reasonable proof that such foreign financing is being offered to, or arranged for, a bonafide competitor for a United States export sale."

Insofar as AID funds are utilized for blending credits, it is stipulated that they be used to finance exports " which can reasonably be expected to contribute to the advancement of the development objectives of the importing country or countries, and shall be consistent with economic, security, and political criteria used to establish country allocations of Economic Support Funds."

The government mixed credits authorized by this Act are to be coordinated by the National Advisory Council on International Monetary and Financial Policies, known as the NAC (which is currently chaired by the Secretary of the Treasury).

In reality, these new authorities change little. Experience has already demonstrated that ESF funds, taking into account constraints on their use, are not a satisfactory source of mixed credit financing because:

- o the available ESF funds are inadequate;

- o the ESF countries are not necessarily those where mixed credits may be needed; and

- o existing ESF allocations must be used, offering no incremental financing to the nation considering alternative sources of purchases.

The new legislation does, however, open the way for more creative or innovative financing by placing the policy coordination function in the interagency framework of the NAC.

The government already has many instruments which could be brought to bear in a coherent mixed credit strategy, including:

- o ESF;
- o Exim-Bank credits, guarantees, discounting capabilities;
- o CCC;
- o P.L. 480;
- o OPIC;
- o FCIA;
- o USDA/FAS market development funds; and
- o Security assistance.

It is also possible to use cofinancing to create mixed credit consequences.

Mixed Credit Options. Two basic options exist: (1) utilize all existing U.S. Government foreign credit programs within one policy framework, with new priorities assigned to mixed credit competition; and (2) secure additional funding specifically to support mixed credits.

The second option is extremely difficult to implement during the present federal budget crisis, particularly in the next year or two. New taxes earmarked for this purpose could not survive executive-congressional efforts to devise a budget compromise. Thus, at present, any new fund would probably have to be based on some form of off-budget borrowing, with a commitment for periodic reprenishment of the fund. This, too, would be difficult to implement, given wider Administration efforts to reduce or limit all off-budget borrowing by federal agencies.

The amounts required for a special mixed credit fund would depend upon whether funds would be provided on a "cash flow basis," or on the same terms offered by competitors. In the first case, a grace period would be covered by a cash flow subsidy or reduction of cash flow. In the second case, a subsidy could take the form of a start-up grant of the present discounted value of the subsidy required over the duration of the project; or there could be regular installments of equalizing payments or reductions of borrower repayments. The impact on annual disbursements, as well as on overall "cost" to the government of subsidization, would vary according to the formula.

It is possible to devise specific types of borrowing that could generate adequate subsidized credit, such as issuance of tax-exempt federal bonds (possibly with the stipulation that such bonds could only be held by certain types of institutions), but there would no doubt be vigorous policy objections to singling out export credit subsidization for such treatment. (A number of state governmnts have tried to use their industrial development bond authorities to raise export assistance funds this way, but the U.S. Treasury has objected.)

The first option could be implemented now, as a first step. This would require tight coordination of programs and explicit guidelines for provision of credit, guaranties, and insurance that would apply to all foreign credit programs. It could be supported by use of remittances to AID and of foreign currency holdings available to AID.

Certain other agencies' reinterpretations of their mandates would also be necessary. For example, AID's definitions of "development needs" would need a new look.

The critical question of establishing the facts about competitive offers needs to be addressed in a fresh manner, taking into account the need for decisions on whether to assist a commercial bid, to be made in a few days at most. Indeed, some support might be considered on an anticipatory basis, using recent patterns of competitive behavior as justification.

The coordinating body could be the NAC, following the most recent legislation. However, the NAC, dominated by the Treasury, has not been used for broad policy coordination in recent years. Rather, most foreign economic policy decisions are formulated in the framework of special cabinet committees (Cabinet Council on Commerce and Trade, Cabinet Council on Economic Affairs, Trade Policy Committee, and the Senior Interagency Group on International Economic Policy, linked to the National Security Council).

Given the present Administration's reliance on special Cabinet committees, supported and staffed by White House personnel, it would be best to lodge the coordinating authority in one of these interagency Cabinet committees, and designate specific White House staff as secretariat coordinators.

In the present administrative framework, the most sensible point of responsibility for this role would be in the National Security Council staff, where trade, aid, financial, political, and security issues converge.

A NEW TRADE DEVELOPMENT STRATEGY

It is clear, then, that there is need for a coherent strategy to meet the challenges posed by the growing role of governments in managing the conditions of world competition. It is not sufficient to threaten retaliation and then rely on multilateral negotiating efforts. The threats may not be effective, given the present orientation of trade policy in many governments. The multilateral negotiating process normally takes years before concrete results can be achieved. By the time negotiations are concluded, the problems that originally prompted action have often been overtaken by new problems.

For the multilateral negotiating process to succeed in the long run there would be need for establishment of long-term objectives related to judgments about the market conditions at the end of the 1980s or in the 1990s.

There is consequent need for a longer-term vision or perspective of the likely problems and opportunities of the next few years. This requires attention to the changing character of business relationships with other nations' markets, as well as to the changing character of the competitive conditions as they are affected by governments (both in buying and selling).

In particular, there should be emphasis in rethinking stragegy on building up private enterprise ties to other nations' economies on a continuing, long-term basis, consistent with the broad American objectives of liberalization of the world economy as a whole, while strengthening the mutuality of economic, social, and political interests between the United States and other nations. In particular, this rethinking should focus on certain basic objectives:

o development of mutual interests;

o enhancement of long-term interrelationships in trade, investment, and other economic activities;

o reorientation of development in directions consistent with market forces; and

o encouragement of entrepreneurship and economic institution-building and leveraging maximum flow of private finance.

The focus of past aid programs on "development needs" was always unclear, because "needs" were defined by policymakers with a particular view, and not by the market. Moreover, "development needs" were often overridden by short-term political and security considerations.

What is good for development ought to be consistent with what is good for expansion of mutual economic activity. A fusion is needed of our objective of developing trade, investment, and service activities with these nations and our objective of developing their capability for self-sustained economic growth.

This in turn tends to strengthen the mutuality of political and security interests between the United States and such countries.

Much recent attention in public debate over American trade policy has been given to reorganization of the executive branch to deal more effectively with trade. However, the problem is less a matter of organization than it is an absence of a coherent American trade stragegy.

Trade issues are mainly dealt with in Washington in response to complaints from individual industries and farm and labor groups or in response to specific conflicts with other nations. The main emphasis in trade policy is on resolving specific import problems, rather than on promoting exports or on improving overall competitiveness.

U.S. policymaking, being primarily driven by complaints, is based upon adversary proceedings between government and industry. Close public-private cooperation in building overseas markets is difficult, and when it occurs, is often criticized ("favoritism"). There has been a proliferation of business and agricultural advisory committees created by federal agencies and sometimes by the President, but no attempt is made to pull together from all of them some national priorities for public-private cooperation. There are no clear objectives (either geographic, or by industrial or agricultural sector) in government trade-related activities. Agencies coordinate very little, except when the White House has critical short-term political or security interests in a particular country or group of countries (e.g., Egypt, Caribbean Basin).

Inconsistencies in policies and mutually conflicting practices are common, rather than exceptional. The regulatory laws and practices generally act to impede trade rather than support international commerce.

Absence of strategy and continuous stop-go or zig-zag courses of action tend to discourage private business efforts to expand exports and to encourage overseas production and R&D where possible and economically sound.

There is no concerted official effort in the United States to develop long-term trade, investment, and other commercial ties on a regional or country basis. (In contrast, the French make major efforts to strengthen and expand commercial relations with Francophone Africa and with the Middle East where they have historical ties; the Japanese concentrate the major part of trade and aid efforts on Asian-Pacific countries, and Brazil and Mexico, where long-term growth prospects appear strongest.)

Although the United States wants greater world reliance on freer markets and on expansion of private sector activities, its trade policies are not consistently geared to these objectives. Achievement of these objectives requires development of long-term trade and investment ties and increased interweaving of other national economies with our own. Development of ongoing, self-sustaining commercial ties requires both public and private effort.

Trade policies of our major competitors tend to take a longer term perspective and are more closely related to domestic industrial, agricultural, and employment strategies. This is primarily because for many years trade represented a far bigger proportion of domestic economic activity in those nations than was true in the United States.

The role of trade in the American economy, however, has grown dramatically in the last decade or so. The share of exports or imports in GNP has more than doubled since 1970 to almost 10 percent. More important, setting aside services, exported goods now represent about a quarter of the production of goods in our farms and factories. That share has more than doubled since 1970. Yet we still act as if trade is a minor aspect of our economic well-being; and we still concentrate policy attention on import problems rather than on export generation.

Organizational Needs

The present framework of government coordination is clearly inadequate to the challenges discussed in this report. There are various ways to improve coordination, including fundamental reorganization of agency roles, but whatever the means, certain objectives should be sought:

o close coordination of policies;

o development of common priorities and government-wide guidelines for specific agency actions; and

o strengthening of public-private coordination.

One option would be to reorganize the entire government to consolidate all trade policy and operations, including official financial support of exports, under one agency. President Reagan's proposal of a new Department of International Trade and Industry (DITI) does not accomplish this. Rather, the DITI proposal excludes agriculture; it leaves all financing operations separate; and it fails to bring together security and foreign policy management of trade and commercial trade management. The DITI concept represents a political compromise geared at present agency interests and present sectoral views without reference to a long-term conception of global strategy.

Major reorganizations are difficult to achieve in a short period of time. They require building up a broad, national consensus on what needs to be done and how to go about it. In this context, creation of a new agency would have to address serious questions of purpose such as:

o Should trade be separated in a single trade department?

o Should trade and domestic economic policies be merged in a department of economic affairs?

o Should industrial trade be combined with domestic industrial policies in a department of industry and trade?

o Should trade be subsumed under foreign policy generally in a redesigned State Department or in a new department of foreign economic policy?

The Congress is already raising such basic questions. The time is not ripe for a new agency, because there is no national consensus.

Another option would be to take incremental steps in the direction of closer coordination, through designation of a single lead agency. At present neither AID nor the Exim-Bank has the status or power to bring about changes in policy of other agencies. No single Cabinet department could dominate without continuous appeals to the White House. The President's DITI proposal is far too modest in scope to provide the necessary policy guidance (it would not have authority over all financial, export credit, or development assistance policies).

Moreover, it is necessary to secure the full support of both domestic and international trade promotion activities of the Commerce Department and Agriculture Department, and field staff of AID, the embassies (including commercial attachés), and overseas contractors.

To provide for linkage of security and economic policy objectives requires an approach that transcends the conventional agency boundaries.

A more desirable first step would be to establish policy coordination from the top, from White House staff, either in the NSC, or in the policy staff supporting the cabinet committees.

Subject to general policy coordination, implementation would then be necessary through a special interagency committee designated to carry out a coherent development and trade strategy. This interagency committee would need a special staff which would become expert in assessing competitive circumstances, especially the policies of other governments.

This group would not succeed if it were limited to responding to specific competitive offers. The reaction time would be too slow. The group would have to: (1) anticipate competitive offers, and (2) be prepared to respond to unfair competition by separate, officially supported countermeasures in other projects or markets.

The policy approach must recognize that multilateral negotiations to correct present government practices are unlikely to succeed in the near future and would, in any event, take several years to complete.

A private sector advisory system is essential. This must be more than a select, small group, to avoid charges of favoritism to members.

A small committee similar to the International Private Enterprise Task Force could provide general policy guidance and make periodic assessments of international competition,

Effective day-to-day operations would also require an elaborate system of business and financial advisers familiar with particular markets and product sectors. However, the advisory system would also need to look beyond the top 20 American exporters of goods to ensure a wider array of expertise. Thus, particular attention would have to be given to:

o both large and small exporters of goods;

o exporters of services;

o banks;

o nonbank financial institutions;

o nonbank, nonfinancial institutions that provide finance for overseas projects or for trade; and

o insurance companies that provide international risk cover.

The easiest way to meet this need would be for the President to widen the scope of the work of the presently constituted system which advises the U.S. Trade Representative (USTR) on negotiating questions. This would include not only the Advisory Committee on Trade Negotiations (ACTN), the Agriculture Policy Advisory Committee (APAC), and the Industry Policy Advisory Committee (IPAC), but also the specialized advisory committees that represent specific agricultural and industrial sectors. The latter are accustomed to choosing among themselves spokesmen to advise on specific sectoral trade issues. This approach would probably gain congressional confidence, since this apparatus is already well known in the key committees of Congress.

In conclusion, an effective approach cannot simply be built around limited, selected coordination of Exim-Bank and AID financing in response to very specific competitive offers. Rather, we need a coherent strategy; common priorities and guidelines for all agencies which provide credit or otherwise influence trade; flexibility to respond or to anticipate as needed; and a more sophisticated multilateral negotiating approach.

26. Michael J. Calhoun, U.S. Disincentives to International Business Activity and Trade, November 1973.

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IV.

FOOD AND AGRICULTURE

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7.

IMPACT OF ADDITIONAL P.L. 480 FUNDING

By the Office of Budget and Program Analysis, U.S. Department of Agriculture

IMPACT OF ADDITIONAL P.L. 480 FUNDING

The staff of the President's Task Force on International Private Enterprise requested an analysis of additional funding for the P.L. 480 program in FY 1984 through FY 1989. The proposal would add $1 billion to the FY 1984 base program level and amounts necessary to bring the total program to $3 billion each year in FY 1985-1989. Table 7.1 shows the additional amounts, raging from $1.203 billion in FY 1985 to $1.339 billion in FY 1989.

The additional amounts were allocated between Title I (concessional sales) and Title II (food donations) at a 75-25 split. Thus, additional funding for Title I was $750 million in FY 1984 and $900 million to $1 billion in FY 1985-1989. Title II additional funding was $250 million in FY 1984 and $300-$335 million in FY 1985-1989. These allocations were based on the advice of the staff of the Office of the General Sales Manager (GSM), Foreign Agricultural Service, which oversees the P.L. 480 program.

Within Title I, about 12 percent of the funds must be used to pay the ocean freight differential (OFD) (See Table 7.2). The OFD is the amount that must be reimbursed to purchasers when commodities are shipped on U.S. vessels, as required by the cargo preference legislation. The amount of reimbursement is based on the difference in cost between using U.S. vessels and foreign vessels.

Within Title II, about 34 percent of the funds are required to pay for shipping. The U.S. Government pays all shipping costs for this program.

After accounting for transport costs, the remaining funds under Titles I and II were allocated among commodities based on advice of the GSM staff (See Table 7.3). The distribution reflects normal allocations among commodities under the programs. Using USDA price projections, the dollar figures were converted to commodity quantities that could be purchased. Where appropriate, secondary products, such as vegetable oil, were converted to equivalent quantities of primary products, e.g., soybeans.

"Additionality" refers to the increase in total exports as a proportion of exports financed. Additionality of 50 to 75 percent for Title I shipments was assumed (See Table 7.4). Additionality of less than 100 percent indicates that P.L. 480 financing substitutes to some degree for some other method of purchase on some sales. Previous studies have assumed additionality for Title I in this range. For Title II, additionality of 100 percent was assumed, because the emergency relief nature of Title II would indicate tht commodities could not be readily purchased otherwise.

These estimated additional exports were then used to modify the supply and demand estimates and the associated outlays for price support and related programs of the Commodity Credit Corporation (CCC). Two sets of estimates were prepared: one based on the assumption that target prices would continue to escalate through the forecast period, and one based on the assumption that target prices would be frozen for the 1985 through 1989 crops at the 1984 crop level. Savings in price support outlays are, of course, larger under the escalated target price scenario.

Table 7.5 indicates the savings in the CCC price support programs as a result of increasing the size of the P.L. 480 program. The savings from additional exports through P.L. 480 occur in two areas: the price support loan program and target price deficiency payments. By drawing down stocks, the additional exports shipped through P.L. 480 tighten up supplies and raise prices. With higher prices, farmers take out fewer price support loans and are likely to market their commodities sooner. Higher prices also encourage repayment of outstanding price support loans. With reduced loan forfeiture, CCC incurs less storage, handling, and transportation cost. Deficiency payments are determined by a comparison between market prices during a legally specified period and the legislated target prices. When market prices increase, deficiency payments decrease.

None of the calculations in this paper accounts for interest costs or savings. With lower outlays for price support loans and deficiency payments, the CCC would have to borrow less money from the Treasury, thus further decreasing CCC outlays in FY 1984-1989, and possibly thereafter. On the other hand, the larger P.L. 480 program would have to be financed by borrowings from the public, since we are in a budget deficit situation. P.L. 480 Title I commodity loans carry a small, very concessional rate of interest (generally 2-3 percent) and very generous repayment terms (initial grace periods and repayments stretching up to 40 years). Thus, interest costs to the government as a whole are likely to rise as a result of the proposed program.

As shown in Table 7.5, CCC savings are relatively modest in FY 1984, approximately $218 million. This is because the period for calculation of deficiency payments ended for all 1983 crops by the time the additional commodities could be purchased in FY 1984. The CCC savings increase each year as the stock drawdown compounds over time, reaching an estimated $982 million (with frozen targets) to $1,422 billion (with escalated targets) by FY 1989. Total savings over the period are projected at around $4 to $5 billion, compared with the total additional P.L. 480 program level of $7.4 billion over the period (See Table 7.6).

Although the increased P.L. 480 program cost is not offset by CCC price support savings over the FY 1984-1989 period, the repayment of the Title I loan principal in future years must also be considered. Assuming that Title I principal is repaid over the long term, then only additional Title II funds and the Title I ocean freight differential (nonrecoverable costs) need be compared to the savings generated in price support programs. The P.L. 480 nonrecoverable cost is nearly $2.5 billion, substantially less than the projected price support savings of $4 to $5 billion. Excluding interest, the resulting benefit and cost ratio is nearly two to one.

In addition, the higher export activity generated by the larger P.L. 480 program increases farm income and stimulates general economic activity (the multiplier has been estimated at two or more) with associated increases in employment. P.L. 480 also has a history of developing and expanding commercial (cash) markets for U.S. agricultural exports. A look at previous P.L. 480 recipients such as Japan, Taiwan, Korea, and Portugal leads to the conclusion that the program indeed has a high benefit and cost ratio over the long term.

TABLE 7.1

P.L. 480 PROGRAM LEVELS
(in millions of dollars)

	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Assumed P.L. 480 Base	$1,552	$1,661	$1,694	$1,728	$1,762	$1,797
Plus: Task Force Proposal	1,000	1,339	1,306	1,272	1,238	1,203
Adjusted Levels	2,522	3,000	3,000	3,000	3,000	3,000
Assumed Title I Base	872	1,011	1,032	1,037	1,049	1,065
Plus: Task Force Proposal	750	1,004	980	954	928	902
Adjusted Title I	1,622	2,015	2,012	1,991	1,977	1,967
Assumed Title II Base	650	650	662	691	713	732
Plus: Task Force Proposal	250	335	326	318	310	301
Adjusted Title II	900	985	988	1,009	1,023	1,033

TABLE 7.2

ALLOCATION OF ADDITIONAL FUNDS TO COMMODITIES, P.L. 480
(in millions of dollars)

	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Title I						
Commodities						
Wheat	$465.5	$ 574.3	$560.6	$545.7	$530.8	$516.0
Corn	20.0	26.5	25.8	25.2	24.5	23.8
Rice	80.0	106.0	103.5	100.7	98.0	95.3
Veg Oil	86.5	132.5	129.4	125.9	122.5	119.1
Cotton	13.0	44.2	43.1	42.0	40.8	39.6
	665.0	883.5	862.4	839.5	816.6	793.8
Ocean freight dif.	85.0	120.5	117.6	114.5	111.4	108.2
Total, Title I	750.0	1004.0	980.0	954.0	928.0	902.0
Title II						
Commodities						
Wheat and products	82.5	110.6	107.6	105.0	102.3	99.4
Feed grains and products	49.5	66.3	64.6	63.0	61.4	59.6
Veg Oil	13.0	17.7	17.2	16.8	16.4	15.9
NFDM	11.5	15.5	15.1	14.7	14.3	13.9
Rice	8.5	11.0	10.7	10.4	10.2	9.9
	165.0	221.1	215.2	209.9	204.6	198.7
Transportation	85.0	113.9	110.8	108.1	105.4	102.3
Total, Title II	250.0	335.0	326.0	318.0	310.0	301.0

TABLE 7.3

CALCULATION OF ADDITIONAL TONNAGE FINANCED, P.L. 480

	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Wheat						
Title I (million $)	465.5	574.3	560.6	545.7	530.8	516.0
Price/bushel	4.36	4.25	4.30	4.45	4.65	4.55
Bushels (million)	106.8	135.1	130.4	122.6	114.2	113.4
Title II (million $)	82.5	110.6	107.6	105.0	102.3	99.4
Price/bushel	5.01	5.125	5.147	5.354	5.587	5.473
Bushels (million)	16.5	21.6	20.9	19.6	18.3	18.2
Corn						
Title I (million$)	20.0	26.5	25.8	25.2	24.5	23.8
Price/bushel	3.40	3.25	3.10	3.25	3.10	3.15
Bushels (million)	5.9	8.2	8.3	7.8	7.9	7.6
Title II (million $)	49.5	66.3	64.6	63.0	61.4	59.6
Price/bushel	4.18	3.449	3.298	3.449	3.298	3.348
Bushels (million)	11.8	19.2	19.6	18.3	18.6	17.8
Rice						
Title I (million $)	80.0	106.0	103.5	100.7	98.0	95.3
Price/cwt.	15.88	17.24	18.60	19.501	19.50	10.501
Cwt. (milled) (million)	5.0	6.1	5.6	5.2	5.0	4.9
Cwt. (rough) (million)	7.5	9.2	8.4	7.8	7.5	7.4
Title II (million $)	8.5	11.0	10.7	10.4	10.2	9.9
Price/cwt.	15.88	17.244	18.604	19.504	19.504	19.504
Cwt. (milled) (million)	.5	.6	.6	.5	.5	.5
Cwt. (rough) (million)	.8	.9	.9	.8	.8	.8
Veg Oil						
Title I (million $)	86.5	132.5	129.4	125.9	122.5	119.1
Price/pound	.344	.334	.302	.294	.284	.284
Pounds (million)	251.5	396.7	428.5	428.2	431.3	419.4
Soybean equiv. (mil. bu.)	24.4	38.5	41.6	41.6	41.9	40.7
Title II (million $)	13.0	17.7	17.2	16.8	16.4	15.9
Price/pound	.460	.450	.418	.410	.400	.400
Pounds (million)	28.3	39.3	41.1	41.0	41.0	39.8
Soybean equiv. (mil. bu.)	2.7	3.8	4.0	4.0	4.0	3.9
Cotton						
Title I (million $)	13.0	44.2	43.1	42.0	40.8	39.6
Price/bale	379.0	356.122	345.395	350.921	362.838	369.054
Bales (million)	—	.1	.1	.1	.1	.1
NFDM						
Title II (million $)	11.5	15.5	15.1	14.7	14.3	13.9
Price/pound	.05	.05	.05	.05	.05	.05
Pounds (million)	230	310	302	294	286	278

TABLE 7.4

ADDITIONAL EXPORTS RESULTING FROM ADDITIONAL TONNAGE FINANCED, P.L. 480

	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Wheat (million bushels)						
Title I (50%)	53.4	67.6	65.2	61.3	57.1	56.7
Title I (75%)	80.1	101.3	97.8	92.0	85.6	85.0
Title II (100%)	16.5	21.6	20.9	19.6	18.3	18.2
Total	69.9-96.6	89.2-122.9	86.1-118.7	80.9-111.6	75.4-103.9	74.9-103.2
Corn (million bushels)						
Title I (50%)	3.0	4.1	4.2	3.9	4.0	3.8
Title I (75%)	4.4	6.2	6.2	5.8	5.9	5.7
Title II (100%)	11.8	19.2	19.6	18.3	18.6	17.8
Total	14.8-16.2	23.3-25.4	23.8-25.8	22.2-24.1	22.6-24.5	21.6-23.5
Rice (million cwt.)						
Title I (50%)	3.8	4.6	4.2	3.9	3.8	3.7
Title I (75%)	5.6	6.9	6.3	5.8	5.6	5.6
Title II (100%)	.8	.9	.9	.8	.8	.8
Total	4.6-6.4	5.5-7.8	5.1-7.1	4.7-6.6	4.6-5.4	4.5-6.4
Soybeans (million bushels)						
Title I (50%)	12.2	19.2	20.8	20.8	21.0	20.4
Title I (75%)	18.3	28.9	31.2	31.2	31.4	30.5
Title II (100%)	2.7	3.8	4.0	4.0	4.0	3.9
Total	14.9-21.0	23.0-32.7	24.8-35.2	24.8-35.2	25.0-35.4	24.3-34.4
Cotton (million bales)						
Title I (50%)	.05	.05	.05	.05	.05	.05
Title I (75%)	.08	.08	.08	.08	.08	.08

TABLE 7.5

PROJECTED CCC OUTLAY SAVINGS DUE TO ENHANCED P.L. 480 SHIPMENTS
(in millions of dollars)

	FY 1984		FY 1985		FY 1986		FY 1987		FY 1988		FY 1989		Total	
	Froz.[a]	Esc.	Froz.	Esc.	Froz.	Esc.	Froz.	Esc.	Froz.	Esc.	Froz.	Esc.	Froz.	Esc.
Corn	$--	--	$ 85	65	$ 38	38	$111	236	$ 171	51	$173	350	$ 558	790
Wheat	202	202	148	148	249	374	411	658	581	766	511	771	2,102	2,919
Cotton	--	--	26	26	68	68	100	100	123	118	165	145	482	457
Rice	8	8	80	80	145	145	145	162	145	165	67	90	590	650
Soybeans	--	--	50	50	28	28	85	85	85	85	50	50	298	298
NFDM	8	8	13	13	13	13	14	14	15	15	16	16	79	79
Total	218	218	382	382	541	666	866	1,305	1,120	1,200	982	1,422	4,109	5,193

a/ Froz. = target prices for 1985-89 crops held at 1984 crop levels.
Esc. = target prices continue to escalate throughout forecast period.

TABLE 7.6

COMPARISON OF COSTS AND BENEFITS
OF ENHANCED P.L. 480 PROGRAM
(in millions of dollars)

	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989	Total
Increased P.L. 480 Program:							
Recoverable							
Title I Commodities	665	884	862	840	817	794	4,862
Nonrecoverable							
Title I OFD	85	120	118	114	111	108	656
Title II	250	335	326	318	310	301	1,840
Total Nonrecoverable	335	455	444	432	421	409	2,496
Total P.L. 480	1,000	1,339	1,306	1,272	1,238	1.203	7,358
Price Support Program Savings:							
Frozen Targets	218	382	541	866	1,120	982	4,109
Escalated Targets	218	382	666	1,305	1,200	1,422	5,193
Net Benefit (Cost):							
P.L. 480 - Frozen Targets	(782)	(957)	(765)	(406)	(118)	(221)	(3,249)
P.L. 480 - Escalated Targets	(782)	(957)	(640)	33	(38)	219	(2,165)
Nonrecoverable Frozen Targets[a/]	(117)	(73)	97	434	699	573	1,613
Nonrecoverable Escalated Targets[a/]	(117)	(73)	222	873	779	1,013	2,697

[a/] Nonrecoverable P.L. 480 = Title I OFD plus Title II. These amounts are not repaid. Amounts for Title I commodities are repaid over 40 years.

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8.

THE CRITICAL AFRICAN FOOD SITUATION: WHAT THE UNITED STATES CAN DO

By the Economic Research Service, U.S. Department of Agriculture

THE CRITICAL AFRICAN FOOD SITUATION: WHAT THE UNITED STATES CAN DO

SUMMARY

Africa currently faces a serious food emergency. Twenty countries in North, West, East, and Southern Africa, with a combined population of some 200 million people, are confronting adverse food production conditions (See Figure 8.1).[28] About nine million people are facing serious nutritional problems and in some cases starvation has already occurred. While Africa has periodic food emergencies, the current situation is unusual in two respects. First, the scope is larger, affecting countries across the continent rather than one specific area (e.g., the Sahel of West Africa in 1972-1974 or Eastern Africa in 1980-1981). Second, in Southern Africa the drought is unusually severe, the worst of the century. Because the drought has affected countries which normally export (most importantly South Africa, and to a lesser extent Zimbabwe), there have been secondary effects on countries which depend on southern African supplies (e.g., Zaire).

These 20 countries will have food aid needs of some 2.8 million tons in 1983-1984, even after record commercial purchases of 4.9 million tons (See Table 8.1). Responding to these short-term needs will require either a very heavy commitment of planned Title I and Title II reserves to the region or expanded food aid commitments. Responding to Africa's long-run food production problems will require investment in research and development of technology and training.

THE CURRENT EMERGENCY

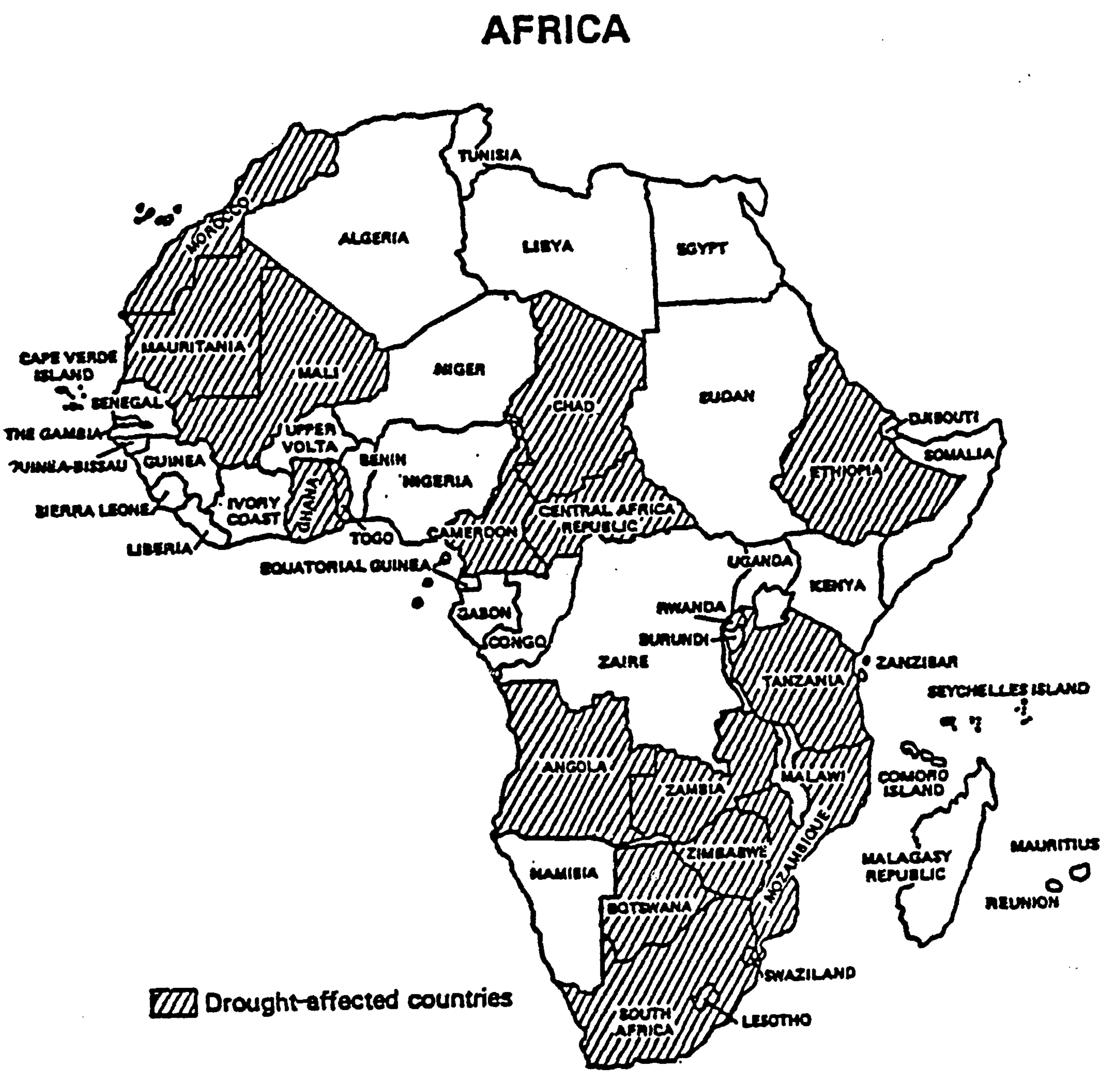
Southern Africa

The most serious food problem is in Southern Africa, where the most severe drought of the century has dramatically reduced production of grain and other crops. 1983 grain production in South Africa was lower by 44 percent than in 1982 and 42.5 percent lower in Zimbabwe; both countries have previously been able to export corn. Several smaller Southern African countries (Botswana, Lesotho, Swaziland) suffered even more severe production declines--up to 60 percent. In addition, the southern half of Mozambique experienced almost total crop failure.

The human and economic implications of the drought are grim. Some 7.2 million people face severe hunger and possible starvation. Corn import requirements for 1983-1984 will rise sharply, with South Africa alone expected to purchase up to 2 million tons. In addition, livestock losses will also be substantial, particularly in Botswana, Zimbabwe, and the Black Homelands of South Africa.

FIGURE 8.1

DROUGHT-AFFECTED COUNTRIES IN AFRICA



East Africa

The most serious food emergency in East Africa is in Ethiopia. Drought in both 1981 and 1982 led to crop shortfalls. Cereal output averaged 4 million tons, down about 10 percent from production under normal rainfall conditions. The drought was concentrated in the northern highlands, inhabited by some 3 million people. Some 700,000 people are reportedly migrating from the region to areas with better food supplies. In addition, Tanzania is facing a food shortage before the July-August harvest, although the harvest itself is expected to be average and comparable to 1982. However, difficulties in government procurement are expected to persist. Finally, Rwanda experienced drought damage to its bean crop, the main staple, increasing aid requirements.

West Africa

Eight West African countries--Chad, Mali, Mauritania, Cape Verde, Ghana, Togo, Cameroon, and the Central African Republic--face food emergencies. The most serious food emergency is in Chad, where severe drought damage in the central-western and eastern areas, coupled with civil disturbance, has put more than 1 million people at risk of severe hunger or starvation. Starvation deaths are being reported in Chad. Elsewhere, Cameroon's food supply is tight in the northern region because of drought. Togo experienced prolonged drought following the complete failure of the small season rains in September-October 1982. Main season rains (April-June 1983) have been delayed and are significantly below normal. Ghana's 1982 grain harvest was down 8 percent, a serious situation given the higher demand from people recently expelled from Nigeria, and grain import needs are expected to rise to 350,000 tons from 200,000 last year.

North Africa

Preliminary estimates for 1983 report a 12 percent decline in Morocco's grain production from last year's good crop. As a result, import requirements will be at least 2 million tons for 1983-1984. Because of foreign exchange constraints, Morocco may need increased food aid, although this has yet to be determined. Depending on the availability of U.S. and European Community (EC) credit, Morocco may import more than the 2 million tons.

AFRICAN PRODUCTION PROBLEMS

African production problems are longstanding. While drought is a major cause of the present African food crisis, the roots of the problem go much deeper. Africa's food situation is precarious. The growth rate of production has remained low over the last decade, averaging about 1.9 percent per year and only 0.8 percent in 1982, while population increased by nearly 3 percent. Most African countries already have per capita calorie consumption levels below Food and Agriculture Organization of the United Nations (FAO) minimum standards. Hence, there is little margin for human error or natural disaster. Yet both occur regularly.

Most food is produced under rain-fed conditions, making it subject to wide weather-related variations. Yet few countries have developed the capacity to deal internally with these fluctuations, and severe foreign exchange constraints limit the ability to import to cover shortfalls. Government officials have frequently neglected the agricultural sector, often tailoring policies toward subsidizing food for politically important urban consumers rather than stimulating increased production. In addition, agricultural price policy, marketing practices, trade policy, and foreign exchange policy have often been inconsistent, making it difficult to cope with changing conditions.

To date, there have been few "breakthroughs" in food production, and higher yielding crop varieties developed elsewhere have proved difficult to transfer to Africa. The future of new agricultural technology will depend on more effective national research with more attention to local conditions. Yet, national research systems are in general weak at the present time and lack trained personnel and adequate funding.

These weaknesses in food production have been compounded by warfare, revolution, and political instability which have reduced food production in many countries and generated flows of refugees. These displaced people put heavy demands on the food systems of neighboring countries and the international community.

Major studies by U.S. Department of Agricultlure (USDA), the World Bank, the FAO, and the International Food Policy Research Institute are unanimous in their conclusions. Without significant changes in the productivity of African agriculture, and better policies and planning capable of providing incentives for greater productivity, there will be increasingly serious food emergencies over the next decade.

FOOD AID REQUIREMENTS AND CONSTRAINTS

Analysis of the FY 1983 situation for these 20 countries indicates that about 1 million tons of additional grain imports would be required, over and above commercial purchases and food aid distributed and allocated as of April 1983. All but about 368,000 tons would be purchased commercially if the countries purchased as much this year as they did last year. Of the uncovered food aid needs, 307,000 tons are in Southern Africa.

An additional $25 million worth of food aid has been proposed for Southern Africa in FY 1983 and 1984. Assuming that the U.S. contribution would cover our "traditional" share of Africa's food aid (58 percent), this additional $25 million would barely cover the FY 1983 shortfall. The region will need an additional 1.3 million tons of food aid in FY 1984, even with record commercial purchases of some 3.4 million tons.

USDA's Food Aid Needs and Availabilities (FANA) estimates that the 20 drought-affected countries will require some 2.8 million tons of food aid in FY 1984, despite record commercial purchases of 6.7 million tons. The proposed allocation of P.L. 480 to these countries is $35 million, with an unallocated reserve of $55 million. Meeting the U.S. "share" of these countries' food aid needs through P.L. 480 Title I would use more than the entire unallocated reserve. The preliminary FY 1984 allocation of P.L. 480 Title II for Subsaharan Africa, equivalent to some 289,000 tons of grain, is about 10 percent below FY 1983. If these allocations were implemented, the implied cuts could not be adequately compensated for by the proposed $25 million emergency fund.

Past experience with African food crises has identified several constraints to effective emergency assistance. Logistical problems often limit volume of food aid which can be effectively used. Such constraints are crucial in Chad, where there are both domestic logistical problems and the additional complication created by the closing of the border with Nigeria. Transportation problems may also be a factor in Southern Africa, where port and railway bottlenecks make food aid costly to deliver. In addition, it has frequently been hard to deliver food aid to hungry people in remote rural areas. Such considerations may come into play in Mozambique and Ethiopia.

WHAT CAN THE UNITED STATES DO?

There are two main objectives for the United States: (1) to respond to the current emergency, thus mitigating the effects of crop failure and eliminating widespread hunger, and (2) to take longer term steps which assure that food aid does not enable governments to postpone needed agricultural change and policy reforms.

The United States can undertake three broad approaches to the African food crisis. First, the proposed $25 million emergency fund for Southern Africa can be created, as a minimum, and expanded for FY 1984. Second, the United States can increase P.L. 480 allocations for the region. These two actions are essentially short-term responses to an immediate emergency. Third, the United States can make a strong commitment to resolving the longstanding problems facing

African agriculture. Here, two areas are particularly critical: (1) encouraging and backstopping policy change, and (2) fostering research and training to promote greater agricultural productivity.

With respect to the longer term, thee is an increasing recognition by African governments that policy changes will be needed to reverse the unfavorable trends of the recent past. The conditions they face are extremely unfavorable, however. On the one hand, they lack the ability to impose unpopular measures by force. On the other, these governments have all embarked on providing social and welfare services on a large scale, causing a drain on their treasuries.

Therefore, the United States should work with African governments to assist them in planning their food strategies to better allocate their limited resources. Support for implementing these food plans is critical. Food aid can be useful in helping to backstop policy changes and supporting governments during the transition stage.

The African countries are still waiting to see the benefits of agricultural research applied to their continent, as it has been in Asia and Latin America. Only through productivity-raising technological changes can the pattern of stagnating food production be broken and African consumers be provided with an assurance of adequate diets in good years and bad. The United States, for its part, can promote a crash effort on the agricultural research front in Africa in the search for such applicable and affordable technologies.

African governments concur with this position, as was demonstrated at the recent Eighth Session of the FAO Committee on World Food Security in Rome. The U.S. delegation stressed the need to focus on a few priority areas, assess progress, and discuss ways of improving coordination and effectiveness of existing aid flows in the priority areas. The U.S. delegation suggested that the focus be on training, research, and delivery systems, a suggestion in accord with the thinking of the African group.

TABLE 8.1

AFRICA: MAJOR CEREALS SUPPLY-UTILIZATION

Country	Baseline production a/	Baseline consumption a/	Current production b/	Current consumption needs b/	Difference current production-consump. b/	Population b/	Import gap: Met by commercial imports c/	Import gap: Met by food aid
	Thousand tons					Thousands	Thousand tons	
Angola	334	665	370	691	321	6,957	240	71
Botswana	53	120	15	130	115	795 d/	65	50
Cameroon	846	1,044	911	1,127	216	9,601	183	—
Cape Verde	5	56	4	57	53	345	20	28
Central African Republic	37	60	42	64	22	2,563	4	26
Chad	526	577	542	617	75	4,944	5	75
Ethiopia	4,140	4,417	4,105	4,637	532	34,078	82	450
Ghana	625	827	680	898	218	13,186	80	166
Lesotho	201	370	70	395	325	1,449	66	259
Mali	1,025	1,125	1,045	1,210	165	7,239	36	129
Mauritania	35	184	32	194	162	1,603	45	116
Morocco	3,784	6,075	4,300	6,631	2,331	22,835	2,131	200
Mozambique	606	993	403	1,062	659	13,046	185	484
Republic of South Africa	13,270	9,614	6,360	10,100	3,740	29,300 e/	2,300 f/	0
Rwanda	257	270	271	293	22	5,617	0	58
Swaziland	85	140	37	150	113	605	17	95
Tanzania	1,505	1,817	1,697	2,027	330	20,524	57	394
Togo	301	353	314	385	71	2,915	17	44
Zambia	820	1,014	818	1,093	275	6,398	202	73
Zimbabwe	2,454	1,800	1,520	1,960	440	7,400	360	80
Total	30,909	31,521	24,386	33,721	9,335	191,450	4,945	2,793

NA - Not Available
— -Less than 1.

a/ 1979/80 - 1982/83, except for Botswana, Republic of South Africa, and Zimbabwe, which is for 1979-1982 crop years.
b/ 1983/84.
c/ Does not take account of stock drawdowns, except where noted.
d/ 1981.
e/ Mid-1980.
f/ Assumes substantial drawdown of stocks to cover shortfall.

Sources: FANA; ERS data for Botswana, Republic of South Africa, and Zimbabwe.

NOTE

28. Angola, Botswana, Cameroon, Cape Verde, Central African Republic, Chad, Ethiopia, Ghana, Lesotho, Mali, Mauritania, Morocco, Mozambique, Rwanda, South Africa, Swaziland, Tanzania, Togo, Zambia, Zimbabwe.