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ALTERNATIVES TO BILATERAL ECONOMIC AID

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COMMITTEE ON FOREIGN RELATIONS

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CONTENTS

PREFACE BY SENATOR J. W. FULBRIGHT, CHAIRMAN, COMMITTEE ON FOREIGN RELATIONS

During recent years, the Committee on Foreign Relations has sought to change the foreign assistance program of the United States. Increasingly, Committee members have expressed concern about the heavy emphasis which has been placed upon military, as opposed to economic aid, and also about the distortions of purpose which have resulted from the bilateral character of our foreign assistance, both military and economic. Though there is significant doubt about the desirability of continuing the military portion of our assistance effort, the United States should continue to assist in the economic development of other nations. If we are to do so, however, it is clear that new approaches are a necessity. For this reason, the Committee requested that the Congressional Research Service of the Library of Congress study alternatives to bilateral economic aid. The paper prepared, which I believe will be of interest to both my colleagues and to the general public, provides an analysis of some of those alternatives.

The study was prepared by Mr. Allan S. Nanes of the Foreign Affairs Division of the Congressional Research Service, to whom I express the Committee's appreciation.

ALTERNATIVES TO BILATERAL ECONOMIC AID

The object of this study is to examine and evaluate some of the leading alternatives to the present U.S. bilateral program of economic assistance to developing countries. It is not intended to be a comprehensive analysis of the comparative merits of bilateral and other forms of aid to foreign countries. It proceeds instead on the assumption that there is interest in Congress in maintaining a U.S. role in the development process free of the drawbacks and shortcomings that have so often been ascribed to bilateral aid.

I. Summary

Bilateral aid, which has many achievements to its credit, has been under increasing critical fire in recent years, and has lost the support of many people who formerly favored it. This report analyzes the following alternatives to bilateral aid: one, multilateral assistance; two, rescheduling and reduction of debt servicing by the developing countries; three, preferential tariff arrangements for the developing countries; and four, the encouragement of private investment by American nationals in the less developed countries (LDC's).

A. Multilateral aid

Insofar as multilateral aid is concerned, the report finds that it would not "take the politics out of foreign aid," at least not entirely; that even a massive shift to multilateral aid would probably not increase the volume of development assistance; and that there is no basis in the record for a belief that multilateral aid would be more efficiently administered than bilateral assistance. The advantage of the multilateral approach to the United States lies in the fact that it would downgrade the importance of political and security considerations as the motivation for U.S. assistance, and would thus accord with the policy of reducing U.S. commitments overseas. Furthermore, the allocation of a larger proportion of aid by disinterested multilateral bodies might well draw considerable sting from charges that the United States employs its aid in an imperialistic fashion.

B. Rescheduling debts

The problem of debt servicing is one of increasing concern to a number of developing countries as it imposes an ever-increasing drain on the foreign exchange reserves which they may use for development. This has led to proposals that repayments be rescheduled and stretched out, and that interest rates be reduced, with such rescheduling and reduction substituted, at least in part, for straight bilateral assistance.

However, any independent action which the United States might contemplate in this regard is limited by the fact that reschedulings are normally worked out with other donor countries. The report notes that there have been twenty-four multilateral reschedulings between 1956 and 1972, involving debts owed by twelve aid-receiving countries. The United States share of these debt reschedulings, assuming a satisfactory arrangement is reached with Chile regarding the $65 million U.S. share of Chilean defaults totaling $160 million between November 1971 and December 1972, is $578.82 million.

The report also notes that loans made by the Agency for International Development, the Department of Agriculture, and the Export-Import Bank are made on ascending scale of hardness. This increases the difficulty of correlating the loans and credits advanced to any debtor country with its capability for servicing its debt. Authorities have noted a need for greater coordination in this area. Congress, which has both experience and expertise in this field, will probably want to avail itself of any opportunity to develop new policies with respect to terms of lending, burden sharing, and the resource requirements of the underdeveloped countries.

Among the remedies proposed for the debt-servicing problems of the LDC's is the proposal linking Special Drawing Rights (SDR's) of the International Monetary Fund (IMF) to development assistance. The use of SDR's is essentially a bookkeeping technique by which members of the IMF settle debts among themselves. So far, however, SDR's have been used largely for meeting short-run dips in the foreign reserves of developed countries. Now the LDC's are pressing for the use of SDR's which are essentially artificial reserves, for development loans and credits. Despite expressed support for this concept by U.S. and Common Market officials, the United States, Britain, West Germany, France and other capital exporting countries abstained, at UNCTAD III, from voting for a resolution urging the IMF to consider all aspects of different proposals for a link between SDR's and development aid.

Other approaches to the debt service problem involve the extension of preferential tariff treatment for the LDC's, and the complete untying of aid. The former is, in itself, a major alternative to the present aid program, which by its very nature is linked to debt repayment. It lies within the power of Congress both to extend preferential treatment to the LDC's and to terminate the system of tied aid. What neither Congress nor the Executive can do is to change the terms of loans extended to developing countries by private lenders, but both branches can throw their influence behind purely unofficial attempts to persuade private lenders to renegotiate easier terms.

C. PREFERENTIAL TARIFF ARRANGEMENTS

Preferential treatment for LDC-produced goods in the markets of the developed countries is perhaps the most widely advertised proposal for remedying the developmental ills of the third world. Its appeal lies in the fact that trade brings in foreign exchange which can be used for purposes of development. In theory, the greater the amount of foreign exchange the LDC's can take in, the more they should be able to grow without outside assistance. The LDC's have been quite persistent in demanding preferential treatment, citing as reasons the fact that despite increases in their export earnings their share in world trade is actually declining, that the terms of trade have been going against them, and that as raw materials producers they need some protection against the fluctuations of prices.

By and large the developing countries are dissatisfied with the tariff policies of the United States. They criticize U.S. non-tariff barriers and concessional trade financing as well. In their view the United States has committed itself to UNCTAD and various organs of the Inter-American system to put generalized preferences for the LDC's into effect. For its part, the United States has expressed its agreement in principle to the idea of preferential treatment, but it will not grant trade preferences to any LDC which has bestowed an exclusive trade preference on some other developed country.

It can be shown that the presumed preferences extended by some of the developed countries actually do little to help the trade of the LDC's. The Common Market, for example, is generous toward those items in which the LDC's can hardly hope to compete, but a good deal more restrictive for those commodities which the Market itself exports in volume. The EEC (Common Market) is also becoming more country have been in response to actions of other developed countries also stand to lose if the United States adopts a more protectionist policy, although the demands for protection that have arisen in this country have been in response to actions of other developed countries and not the LDC's. The developing countries are also hurt by the fact that as a general rule tariffs tend to increase with degree of processing, so that whatever finished products they are able to manufacture will face greater hurdles than their raw materials or semi-finished goods.

Various suggestions have been advanced as to how the United States might use trade policy to help the less developed countries. Some say this country should press for a broader range of international commodity agreements, but the record of such agreements is not encouraging. Diversification has been recommended instead, but poor nations find it difficult to diversify with no assured market for their new products. Also diversification means investment, and the United States would be acting inconsistently to urge diversification on the LDC's without being prepared to assist in the process. Or the LDC's can be encouraged to increase trade and development among themselves, particularly through the establishment and operation of regional organizations. The United States has generally supported regional trade collaboration and development, although the degree of that support has varied according to the area involved.

The way has been cleared in GATT should the United States decide to adopt a preferential tariff system for the developing countries, but strong public and Congressional opposition to such a policy can be expected. Not only could such a move be interpreted by some as making concessions to foreign governments at the expense of the American worker, but as endorsement by Congress of a "commitment" made by the Executive without consulting Congress, in a field where Congress' constitutional power is unquestioned.

94-942—72—3

The report also points out that nowhere in the sources examined was a preferential tariff system viewed as a complete alternative to aid. Supporters of foreign aid would probably prefer the introduction of preferences with care and caution, lest a generalized introduction cause the kind of economic dislocation at home that would erase the last vestiges of support for any form of aid.

D. PRIVATE INVESTMENT

Many developing countries do not view private investment as a form of development aid, because of profit repatriation particularly. But developed countries argue that private investment makes a substantial contribution to development and hence must be considered as development aid. At any rate, private American investors have invested twice as much in the developed world as in the underdeveloped. The greater stability of the developed countries is certainly an important reason for this ratio. The largest share of U.S. private investment in the third world, geographically, is in Latin America; while in terms of industry the largest amounts, irrespective of area, can be found in the extractive industries, principally petroleum.

Private investment contains inherent defects as a means of assisting development, because private investment decisions are made on the basis of safety and profitability, not on the basis of their need as a stimulus to development. If a developing country seeks to direct the investment within its borders, it risks driving away foreign capital. If the developed country tries to persuade or direct its nationals where to invest abroad, it compromises the essentially private nature of those investments. The United States tries to reduce the risk to private American investors in the LDC's through a variety of guarantees and insurance programs.

The developing countries display a considerable ambivalence toward U.S. private investment, and difficulties over nationalization have increased in recent years. In general, private investment appears highly vulnerable both at home and abroad, and it seems too much to expect it to supplant bilateral assistance altogether. Some combination of bilateral aid and private investment appears to be the projection for the future, although the ratio may be changed. Both private investors and the U.S. government should be concerned that the developing countries make the most efficient use of private U.S. resources.

E. AID AND THE FUTURE

The aid program for the foreseeable future is likely to be electric, encompassing different permutations and combinations of multilateral and bilateral aid, private investment, and perhaps changes in trade policy favorable to the LDC's. It lies within the power of Congress to redraw the guidelines, and to see that the best thinking on development is brought to bear on foreign aid programs.

II. Multilateral Aid—Its Advantages and Disadvantages

A. CAN MULTILATERAL ASSISTANCE TAKE THE "POLITICS OUT OF FOREIGN AID?"

1. The alternative which often seems to have the greatest appeal for those who want to see a continuation of U.S. interest in the development process is multilateralism. Multilateral aid, whether under the auspices of the International Bank for Reconstruction and Development (World Bank), the United Nations Development Program (UNDP), or through use of the Special Drawing Rights (SDR's) of the International Monetary Fund, or regional or even subregional agencies, seems to be increasingly viewed as an appropriate vehicle for transferring resources from the developed to the less developed world.

One of the principal arguments for multilateral assistance is that it should minimize the political and security rationale for aid. This should coincide quite nicely with present U.S. policy, which is to present a "low profile" to the rest of the world. To the extent that multilateral aid supplants U.S. bilateral aid, the influence of the United States would presumably diminish in those countries where it has been the principal donor. Instead, under an expanded multilateral effort, the United States could participate in a variety of programs or provide the major share for financing new projects without exercising or appearing to exercise undue influence on the affairs of the receiving countries.

2. Since multilateral economic aid would dilute direct U.S. involvement with the aid-receiving countries it may diminish or eliminate the chances for an open ended military commitment such as this country undertook in Vietnam. By and large the donor countries would be under no obligation to defend a particular government or to uphold a particular political philosophy.[1]

3. Multilateral aid is also said to be advantageous because the short run destabilization and disorganization which characterize the early stages of development cannot then be attributed exclusively to the United States. The reverse side of this coin is that the developing countries themselves might find the dislocations of development more acceptable if they result from programs sponsored by a disinterested multilateral source, but considerably less acceptable when they result from bilateral programs sponsored by the United States.

4. Whatever the advantages of multilateral aid, it is difficult to envision bilateral aid being phased out altogether. Even if the United States adopts such a course, other aid-giving nations are not necessarily going to follow suit. (It seems highly unlikely, for example, that

[1] Multilateral agencies formed for essentially political purposes seem unlikely to distribute any development assistance to governments which expouse a political philosophy abhorrent go most of the members. Cuba, for example, gets no help from the Organization of American States.

either the Soviet Union or the People's Republic of China would surrender control of all the development assistance they provide to some international agency).

The plain fact is that the overwhelming percentage of assistance furnished to the developing countries is provided on a bilateral basis.[2]

a. Nevertheless it cannot be assumed *a priori* that bilateral and multilateral aid programs will operate at cross purposes in the developing countries. Some conflicts may well arise, but with proper planning and a collaborative spirit on the part of all concerned they should not prove insurmountable.

5. Even if we assume a reversal of the present bilateral-multilateral ratio in aid giving, so that 80 to 90 percent of development assistance is distributed through multilateral organizations, the funding would still originate with the member countries. That is the crucial fact, and its political implications both for the multilateral aid agencies and the developing countries need little elaboration.

6. The less developed countries may see a form of political advantage in the multilateral approach, particularly the United Nations Development Program. Multilateralism gives them an opportunity to bring their problems to a world forum, and to "share the driver's seat with the donors,"[3] a privilege not always readily extended under bilateral aid.

7. All in all, it seems somewhat naive to assume that a massive switch to multilateral aid programs will "take the politics out of foreign aid."

Some countries, e.g. France, will probably continue to pursue political goals, such as enhanced influence in particular areas, via simultaneous bilateral programs, and even via multilateral channels where possible. The United States may achieve a lowered profile by switching the bulk of its assistance to multilateral programs, but as the largest donor, this country will remain peculiarly susceptible to charges of manipulating aid to serve our political purposes even when such charges may not be justified. By the same token, the United States will remain a tempting target for criticism by both the developed and less developed countries should ill-conceived or unsuitable multilateral programs end in failure.[4]

a. It might be noted in passing that the Soviet Union, Poland, Romania, and Bulgaria are members of the Governing Council of the United Nations Development Program. If we judge by their actions in other United Nations social agencies they will act in a highly political fashion when it suits their purposes.

8. Since the United States has emphasized the political and security basis of aid in the past, and since many will question the sincerity of a U.S. commitment to a primarily multilateral effort, it is important that the United States avoid behavior and actions which others might characterize as overbearing or intimidating. In other words, a lowered

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[2] The Pearson Report, *Partners in Development*, puts the figure for multilateral aid at 10 percent of official development assistance. The Report, published in 1960, recommends a doubling of multilateral aid programs by 1975.

[3] Asher, Robert E., *Development Assistance in DD II*: The recommendations of Perkins Pearson, Peterson, Prebisch, and others. Washington, Brookings Institution, 1971, p. 107.

[4] Peru has charged, for example, that American pressure has been blocking loans from the World Bank. Without evaluating the merits of the case, this is the type of charge the U.S. may expect to face in many multilateral bodies. See Washington Post, June 5, 1972, p. 2–6.

U.S. profile in the various multilateral programs may contribute more at this time to the success of those programs than a very active U.S. presence.

9. Certain types of programs may lend themselves better to a multilateral approach than a bilateral one. For example, the Stockholm Conference illustrated that the entire environmental question can be more effectively dealt with if it is cast in an international context, rather than being identified with the interests or policies of a particular country. Given the sensitivities and suspicions of the LDC's, especially as they relate to the United States, it could be quite important that assistance for pollution control, for example, be dispensed by a multilateral, and presumably disinterested agency. At the same time the technology and equipment for dealing with environmental problems is most advanced in this country, and U.S. producers will probably benefit just as readily if the program is administered multilaterally as they would if it were strictly bilateral.

B. WILL MULTILATERAL AID INCREASE THE TOTAL VOLUME OF DEVELOPMENT ASSISTANCE?

1. Present volume and trends in multilateral assistance.

a. The record indicates that the amount disbursed to multilateral organizations from the developed countries has been increasing. In 1970 it was up to $1.124 billion, an increase of almost 8 percent over the preceding year. However when this increase is translated into shares of the gross national product (GNP) of Development Assistance Committee (DAC) members, the percentage remains an unchanged 0.06 percent. However it does represent an increased proportion of official development assistance, rising from 15.8 percent in 1969 to 16.5 percent in 1970.[5]

b. Net flows from the United States to developing countries reached $5.971 billion in 1970. This is almost a record, although it represented only 0.61 percent of the U.S. GNP.[6] However official development assistance from this country declined from $3.092 billion in 1969 to $3.050 in 1970, in terms of the prices prevailing for those respective years. Expressed as a percentage of the GNP, this represented a decline from 0.33 percent to 0.31 percent. Despite this fall in official development assistance, however, official flows from the United States to multilateral organizations increased by $393 million in 1970. The OECD's 1971 Review of Development Assistance indicates that the total of U.S. official development assistance in 1971 would approximate that of 1970 "as estimated increases in multilateral flows would be largely offset by continued falls in bilateral disbursement".[7] (However this estimate did not take cognizance of the 10 percent aid cut of August 1971.)

c. A comparison of development assistance data from all the DAC countries from 1960 through 1970 indicates a steady increase in the volume of official bilateral assistance each year except 1965 and 1968. (See Figure 1.) Government contributions to multilateral organizations declined however in 1961, 1962, 1963, 1965, 1966, and 1968, de-

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[5] Organization for Economic Cooperation and Development. Development Assistance. 1971 Review. Paris. 1971, p. 36.
[6] Ibid., p. 38.
[7] Ibid., p. 39.

spite the fact that total official development assistance went up in every one of those years except 1965.[8] The ratio of bilateral to multilateral assistance ranged from approximately 16 to 1 to approximately 5 to 1 insofar as official development assistance was concerned.

[8] See Figure 1. Source OECD 1971 Review of Development Assistance, Table II–1, p. 34.

TABLE II-1.—NET FLOW[1] OF FINANCIAL RESOURCES FROM DAC COUNTRIES, 1960-70 (NET DISBURSEMENTS)

[In million U.S. dollars]

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
I. Official development assistance	4,665	5,197	5,442	5,770	5,957	5,916	6,001	6,552	6,316	6,610	6,808
1. Bilateral grants and grant-like flows	3,692	3,991	4,020	3,940	3,806	3,714	3,701	3,578	3,344	3,250	3,298
2. Bilateral loans at concessional terms	439	685	911	1,463	1,746	1,854	1,966	2,238	2,289	2,312	2,386
3. Contributions to multilateral institutions	534	521	511	367	405	348	334	736	683	1,047	1,124
II. Other official flows	300	946	542	245	−41	283	430	507	731	582	1,159
1. Bilateral	233	716	527	248	−34	278	377	488	741	597	886
2. Multilateral	67	230	15	−3	−7	5	53	19	−10	−15	273
III. Private flows	3,150	3,106	2,453	2,557	3,729	4,121	3,959	4,381	6,380	6,478	[2] 7,575
1. Direct investment	1,767	1,829	1,495	1,603	1,572	2,468	2,179	2,105	3,045	2,804	3,408
2. Bilateral portfolio	633	614	147	327	837	655	480	800	972	1,277	803
3. Multilateral portfolio[3]	204	90	239	−33	461	247	175	469	767	419	343
4. Export credits[4]	546	573	572	660	859	751	1,124	1,007	1,596	1,978	2,174
IV. Grants by private voluntary agencies											840
Total net flow	8,115	9,249	8,437	8,572	9,645	10,320	10,390	11,440	13,427	13,670	[2] 15,542

[1] Gross disbursements minus amortization receipts on earlier lending.

[2] Including grants by private voluntary agencies. On the same basis as for other years, total private flows (item III) would read 6,735 and the figure for total net flow would read 14,701.

[3] These funds of private origin are mingled with those under I-3, and II-2 and other funds from non-DAC sources, in programs governed by criteria similar to those applied in bilateral official development assistance programs.

[4] Measured by some countries as change in outstanding amounts guaranteed, by others as change in outstanding amounts due on disbursed credits. Interest is included in the sums recorded as outstanding, so that the net flow tends to be overstated if gross new guarantees are rising, and vice versa.

d. An examination of Figure 1 demonstrates that the total flow of private assistance to the developing countries has gone up consistently since 1966. Figure 1 also reveals that direct private investment by the developed countries in those nations undergoing development tended to fluctuate, and this is confirmed by Figure 2. Voluntary grants, on which data were available for OECD use for the first time in 1970 amounted to $840.2 million, of which the United States supplied $578 million. Like public flows, private flows were adversely affected by inflation, so that although total private net flows to the LDC's increased by about $260 million in 1970 over the preceding year, the actual effect was a very slight decline.[9]

2. Although official contributions to multilateral organizations have fluctuated in the past (See B 1. c. above), the Development Assistance Committee of OECD expects them to rise in the future as they did in the last few years. Indeed, the 1971 Review of Development Assistance says that the achievement of the Pearson Commission's recommendation that 20 percent of official development assistance be disbursed through multilateral channels seems feasible,[10] provided the multilateral institutions show that they can use the additional funds effectively. To do so, the OECD Review states, they have to improve their programming and administration, and the international lending bodies will need to display a greater flexibility and a more innovative approach in allocating and transferring funds.

But based on past performance it is difficult to sustain the contention that a massive shift to multilateral aid (perhaps far exceeding 20 percent) will produce any significant increase in the total volume of aid. The basic problem, as seen by those deeply involved with development problems, is to increase the flow of all types of aid. Multilateral assistance may well increase over the decade of the 1970's, but that is no guarantee that the total volume of aid will increase commensurately. Donor nations may cut back on bilateral flows as they increase their multilateral contributions, just as the United States has done.

For multilateral aid-giving agencies are handicapped in the same fashions as other international agencies that depend on cooperative effort in that they cannot compel cooperation. They cannot, in this instance, pry contributions from the sovereign nations that constitute their membership. The fact that the donor countries surrender exclusive control of the distribution of their aid funds when they make them available to a multilateral agency no doubt acts as a deterrent to a loosening of the purse strings. It seems safe to assume that whatever reservations the United States may have on this score are to some degree duplicated by other large donors.

In order to increase the flow of assistance, both public and private, to the developing countries, people in the developed countries not only have to be convinced of the need, somehow they have to see increased development assistance as being in their interest. So far their natural reluctance to have their own national resources transferred for the benefit of foreigners has not been overcome. Disappointment at this state of affairs has led some to draw the conclusion that in order to have effective development the world must go beyond the nation-state

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[9] Organization for Economic Cooperation and Development, 1971 Review of Development Assistance. *Op. cit.*, pp. 37–38.
[10] *Ibid.*, p. 51.

as the basic unit of human organization.[11] Humanity, they aver, must transcend nationality. But such a change appears most unlikely, and among its strongest opponents we would find most of the developing countries, which have a very high level of national consciousness.

C. CAN MULTILATERAL ASSISTANCE BE MORE EFFICIENTLY ADMINISTERED THAN BILATERAL ASSISTANCE?

1. In this connection the most severe criticism comes from within the United Nations family, the so-called Jackson Report on the United Nations development system.[12] The Pearson Report also points out specific areas in which multilateral aid organizations need to improve their administration.[13]

Among the problems in administering United Nations aid programs which these reports point up are the following: the dearth of adequate facts and figures, so that no one in the various United Nations development programs has a complete grasp of their operations; the lack of an appropriate office which can both deal with the developing countries on behalf of all U.N. aid agencies, and which could serve at the same time as a coordinating authority for U.N.-sponsored programs. As it is, the lack of appropriate coordinating machinery has contributed to some dispersion of effort by the various U.N. agencies which has detracted from the overall effectiveness of their programs. In addition it has been noted that the multilateral aid agencies often experience recruiting difficulties and compete with each other for the same pool of skilled personnel. Thus recruitment tends to be slow, with a resulting negative effect on development programs. Morale problems arise if one agency is able to offer better salaries or benefits than others engaged in very similar work. Short term contracts mean that the multilateral organizations often do not get the best qualified people, and the continuity of their operations obviously suffers. Their personnel problems are still far from being solved.

Furthermore, no multilateral organization has the network of field missions that the United States maintained at the height of its bilateral program. The UNDP Resident Representative in a developing country has nothing like the authority which a U.S. aid mission director in the same country might enjoy. Nor have the multilateral agencies formulated anything like the country-programming process used for U.S. aid. If multilateral resources are to be allocated more efficiently something like a country-programming mechanism would appear to be needed, and in fact the World Bank has taken at least one step which can be interpreted as a move in that direction. This consists of an expanded program of country economic reports which would be rendered by regular annual missions to developing countries. In these reporting missions, qualified people would perform sector analysis, personnel from the Food and Agriculture Organization (FAO) would report on the status of agriculture, a representative of the International Labor Organization (ILO) would cover manpower, and so on. The Jackson Report proposes something along the

[11] Harry G. Johnson, "Pearson's 'Grand Assize' Fails." Round Table. January 1970, pp. 24–25.

[12] Jackson, Sir Robert G. A., *A Study of the Capacity of the United Nations Development System*. 2 vols. United Nations. Geneva. 1969. 510 pages.

[13] Pearson, Lester B., *Partners in Development*. Report of the Commission on International Development. New York. Praeger. 1969, pp. 215–230.

same lines for the United Nations Development Program, and action to implement its recommendations has already begun.

2. The fact that both the World Bank and the UNDP have begun a somewhat similar approach toward integrated country-programming can be seen as illustrating the parallel evolution of these multilateral agencies on the one hand, or as indicative of their potential rivalry on the other. Robert E. Asher of the Brookings Institution leans to the latter interpretation. He puts it as follows: "Sir Robert Jackson is obviously uneasy about the threat to the rest of the U.N. machinery implicit in a unilateral expansion of the bank's responsibilities for progress reporting and, though it is not self evident to me, asserts that 'it is self-evident * * * that UNDP's operations must expand at about the same rate as those of the Bank.' "[14] A further quotation from the Jackson Report illustrates the point in a forceful fashion:

> The World Bank Group should be the chief arm of the UN system in the field of capital investment, while the UNDP should perform the same function for basic technical co-operation and pre-investment. However, as I have indicated, a number of forces, now converging on both organizations—not all of which are under their control—could produce a very different balance between them. There is, therefore, a very real danger that the centre of gravity for pre-investment work could be pulled away from UNDP to IBRD. If this happened, the result would be a negation of one of the basic functions for which UNDP was specifically created: to fill the "pre-investment gap." If governments do not give UNDP all the resources it needs to play its *full* role, then, in plain language, it must become, by sheer force of circumstances, a junior partner of the World Bank in that field. Is this the wish of governments?[15]

3. This problem of the relationship between the UNDP and the World Bank Group is cited by Sir Robert as a manifestation of the inherent inconsistencies and structural deficiencies of the United Nations development system. Yet one reason for these difficulties is, as the Jackson Report stated, that the Bank and the UNDP have been concerned with different aspects of development. The so-called World Bank Group, consisting of the International Bank for Reconstruction and Development, the International Development Association, and the International Finance Corporation, commands more capital than the UNDP, but it has built its reputation on the appraisal and management of large capital projects. The U.N. Development Program has been concerned more with pre-investment surveys and technical assistance. This division of labor seems logical rather than arbitrary, and it offers hope that any attempt to restructure the machinery of multilateral assistance will be approached in a conciliatory spirit.

4. If restructuring of the multilateral aid effort seems appropriate for purposes of clarity and coordination, it may be even more necessary as a device to elicit support from private citizens and political leaders who favor greater use of multilateral machinery, but who need some central organization around which they can rally. If multilateral aid suffers administratively from diffusion of effort, the same may be said for it politically. A more tightly organized and unified structure might thus be advantageous in terms of focusing political support as well as for reasons of pure efficiency.

5. The answers given to the question as to whether multilateral assistance can be more efficiently administered than bilateral suggest

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[14] Asher, Robert E., *Development Assistance in DD II, op. cit.*, p. 112.

[15] Jackson, Sir Robert G. A., *A Study of the Capacity of the United Nations Development System, op. cit.*, vol. 1, p. 21.

that for the present, at any rate, it is not. This could change with time, but right now greater efficiency can hardly be claimed as an advantage of multilateral programs over those that are bilaterally administered by the United States.

6. One approach to multilateral aid that might provide a useful flexibility, although it would certainly not mean a more tightly knit structure, is that of the Consortium. When an international aid consortium is formed, a number of doners come together with the recipient to work out a common strategy in the provision of aid. Consortia can be concerned with a concerted attack on the developmental problems of an entire country, or they can assist a single project or a single sector of the economy. They can be mixed entities, composed of governmental agencies, multilateral agencies, and private lenders or investors. In the Mekong Project some 25 countries outside the region have been involved, plus four countries of Southeast Asia, plus twelve United Nations functional agencies plus at least one foundation. The India Consortium, on the other hand, consisted of just five founding member countries plus the IBRD/IDA, but five additional countries later joined. John White, in *Pledged to Development* sees the consortium as probably the largest feasible unit of effective operations and co-operation.[16] However the consortium denial is not a panacea and friction between donor and receiver is just as likely to occur if this form of aid giving is adopted, particularly where aid is conditioned on the adoption of certain policies by the receiving country.

D. THE BASIC ADVANTAGE OF MULTILATERALISM

Since multilateral assistance will not wholly take the politics out of foreign aid, and since it is not demonstrable that such assistance will result in raising greater sums for development nor make for a more efficient administration of aid, what advantage can legitimately be claimed for multilateralism? One answer can be found in III A I above, namely that U.S. contributions to multilateral aid organizations do serve to reduce the importance of political and security factors as justifications for U.S. assistance. As U.S. funds are filtered through international bodies the choice of recipients and the policies followed toward them do not depend exclusively on U.S. interpretations of its security requirements. The United States thus becomes a far less credible target for its critics in both developing and developed countries insofar as its policies toward the former are concerned. Criticism will not be eliminated, but some of its sting should be drawn.

Furthermore, by reducing reliance on the security rationale, U.S. aid could be put on what many feel is a sounder basis: considerations of broad humanitarian interest. They further contend that with the United States as a leading participant in a great multilateral effort for the economic modernization of the world's poor nations, much of the support for foreign aid that has eroded in recent years could be won back. The validity of this hypothesis can only be tested, however, if multilateral programs and the U.S. role therein are considerably expanded. Present indications do not point in that direction.

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[16] White, John, *Pledged to Development*. Overteur Development Institute, London, 1967, p. 27.

III. Servicing Debts—Impact and Options

A. THE SCOPE OF THE DEBT SERVICING PROBLEM

1. One problem faced by developing countries for which a solution must be found, and found rapidly, is that of debt servicing. Repayments of interest and principal constitute a severe drain on their foreign exchange resources which, if not arrested, could bring development to a virtual halt in some countries. The problem is characteristic of both bilateral and multilateral aid programs. The question is: what alternative policies can offer the promise of halting this drain?

While noting that available statistics on external debt are not wholly reliable, the 1971 Report of the World Bank states that it is safe to say that by the end of 1969, 80 developing countries owed almost $59 billion in external public debt.[17] Half of this amount was owed by only eight countries, namely India, Pakistan, Brazil, Mexico, Indonesia, Iran, Argentina, and Chile, in that order.[18] Of these, India owed by far the greatest amount, over 8.9 billion dollars. The Bank's Report further states that from 1970–1975 developing countries will have to make service payments of $19.83 billion on an outstanding debt to official creditors of $43.41 billion. This is a ratio of debt service to outstanding debt of 46 percent. Service payments on debts owing private creditors for the same period come to $12.97 billion on $15.53 billion of outstanding debt, a ratio of 84 percent. In a few countries, Argentina, Brazil, Mexico, Peru, the Philippines and Yugoslavia, the ratio of debt service payments to debts outstanding to private creditors is expected to be close to 100 percent, or even higher, in which case these countries could be paying private creditors more in amortization and interest than the actual amount of their debts to such creditors.

Obviously debt servicing problems can create acute difficulties for some of the developing countries. But there is a feedback which affects the donor countries as well. For as Willard Thorp points out, "total assistance will have to grow higher and higher to make possible increased payments to the suppliers of assistance.[19] These increased repayments to the suppliers of assistance mean an actual decline in such assistance even when it appears to increase, unless the increase in aid is large enough to allow for this offsetting back flow. To put it another way, sharp increases in debt servicing expenditures put an added crimp in the often slender foreign exchange resources of the developing countries. This necessitates increased assistance by the developed countries in order to maintain a fixed net flow of development aid, and any agreed contribution to LDC growth rates. Thus

[17] International Bank for Reconstruction and Development. International Development Association. Annual Report 1971. World Bank/IDA. Washington. 1971, p. 50. Amount owed to bilateral, multilateral and private creditors.
[18] *Ibid.*, Statistical Annex. Table 6, p. 64. Ranking done by author.
[19] Thorp, Willard, *The Reality of Foreign Aid.* Praeger, New York, 1971, p. 210.

there is a direct relationship between the increase in debt service payments by the LDC's and the ability of the developed countries to meet the Second Development Decade target of a flow of one percent of the GNP by 1975.

2. There are a number of factors behind the debt servicing problem of the LDC's, but two have been characterized as fundamental.[20] One is the productivity with which capital may be employed by the borrowing country, and the second involves the transformation of output into foreign exchange which can be used for debt servicing. The productivity of capital is to some extent a function of the kinds of available projects on which that capital can be put to use. Unfortunately some developing countries are handicapped by a shortage of projects which will yield a return comparable to that earned in invested capital in the developed countries, or to the cost of capital on the international markets. Their borrowings must be repaid before the new facilities or the newly trained manpower can bring a financial return.

In addition, developing countries often have greater difficulty in converting investment earnings into foreign exchange than do those countries already developed. Many LDC's are raw materials producers who have found that if they substantially increase their production of rubber, sugar, textile fibers and the like, prices are likely to go down. Or their products may face tariff barriers, quantitative restrictions, or both. This is the situation which has given rise to demands for preferential treatment for the products of the LDC's in the markets of the developed countries. For there appears to be an intimate realtionship between the debt service problem of the LDC's and their demands for preferential trading treatment. Should such treatment actually be instituted, many of the LDC's would expect to ease their debt service burdens considerably.

3. The debt service problem is also exacerbated by the practice of most aid donors of tying their aid to a particular procurement source. This may result in a situation where the recipient actually has to pay more for its aid, since it may be unable to purchase from the cheapest source but still has to pay a fixed rate of interest. In a like manner the real value of grants is reduced.

The United States has followed a policy of tied aid since 1959. Prior to that time the law permitted the procurement of aid items anywhere in the world, although it had always required that one half such goods be carried on American ships. Under the Foreign Assistance Act of 1961 (as amended) and its implementing regulations, offshore expenditures are limited to such items as salaries and payments to overseas personnel and contractors, procurement for Vietnam in certain countries which must, in turn, buy from the United States, contributions to international organizations, the procurement costs for administrative and technical assistance in the LDC's when U.S. costs would be at least 50 percent higher, and finally, limited purchase abroad of parts and accessories which originate in the United States but are locally available.[21]

Presumably these provisions account to a considerable degree for the fact that, as an example, roughly 92 percent of total AID expenditures

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[20] World Bank/IDA. Annual Report. 1971. *Op. cit.*, p. 52.

[21] Thorp, Willard, *The Reality of Foreign Aid. Op. cit.*, pp. 213–214. Confirmed by conversations with General Counsel's Office, AID.

in 1967–68 were in the United States. It should also be noted, with respect to the debt service problem of the LDC's, that food distributed under P.L. 480 originates in the United States, and that most Export Import Bank loans are used for the purchase of U.S. commodities.

As noted previously, other donor countries also tie their assistance to purchase of their goods.[22] It is a form of export promotion which many countries apparently find desirable. Yet as Thorp points out, many of the goods and services are bound to come from the country providing the assistance, and all grants are almost certain to come from the grantor.[23] The result is likely to be higher prices for the goods and services which developing countries need. Since aid-tying now features virtually all bilateral programs of any consequence, the mutual cooperation of donor countries will be necessary if the practice is to be reduced or eliminated. DAC has exerted pressure in this direction, and some governments have responded in a less than enthusiastic manner, with measures such as technical advice on efficient purchasing. The feeling seems to be that until the United States takes decisive action against it, aid-tying will continue to characterize development assistance programs.

a. The United States has shown little disposition, however, to modify the policy of tied aid in a really significant way. Indeed in 1967 the concept of additionality was introduced by administrative regulation into the U.S. aid program, further tying aid.

The thinking underlying additionality was as follows: If the recipient of aid would have purchased a particular product in the United States even in the absence of aid, then aid actually freed some of that country's foreign exchange for purchases elsewhere.[24] Additionality required that the recipient countries use their aid credits for purchases "in addition" to their normal import of U.S. goods. In effect it compelled them to purchase specific items in the United States that they might not buy otherwise, or would buy from some other country.

Additionality was infavorably received by U.S. aid beneficiaries, and proved very difficult to administer. The program was vulnerable to the criticism that it was designed more to promote U.S. exports than to foster development. Aid was withheld from some countries while they struggled to erect a system of export controls capable of guaranteeing additionality, while at the same time the United States officially expounded the virtues of the free market. Additionality was resented with particular bitterness in Latin America, where it became "not only a serious practical impediment to the distribution of authorized nonproject aid but also a new symbol of *gringo* imperiousness." [25]

The Latin Americans strongly criticized both tied aid and additionality in the Consensus of Vina del Mar in May of 1969. In June of 1969 additionality was terminated, much to the relief of those trying to administer it.[26] On October 31, 1969, President Nixon untied Latin

[22] See p. 29.
[23] Thorp, *op. cit.*, p. 214.
[24] Hutcheson, Thomas L., and Richard C. Porter, The Cost of Tying Aid: A Method and Some Colombian Estimates. Princeton Studies in International Finance No. 30. Department of Economics, Princeton University, 1972, p. 10.
[25] *Ibid.*, p. 16.
[26] Thorp, *The Reality of Foreign Aid*, *op. cit.*, p. 216.

American aid a bit by permitting dollar credits advanced to Latin America to be spent in Latin America. This action was broadened in the President's foreign aid message of 1970, in which he announced that virtually all low income countries would be permitted to use their dollar credits to finance procurement throughout the underdeveloped world as well as the United States. At the same time the President stated that the complete untying of aid had to be a step taken in concert with other nations, and noted that the United States had begun talks to that end with the other members of DAC. Those talks have apparently not progressed, however, for no agreement has been reached by the donor countries which would completely untie foreign aid. Nor have the developing countries found very much use for their dollar credits in other LDC's.

4. The difficulties of debt servicing have been exacerbated in recent years by four factors, according to the Pearson Commission. One was the steadily increasing proportion of loans under the various official aid programs. Second, the terms of some of these loans, particularly export credits, were hardened somewhat during the middle 1960's. Third, the increasing cost of money on world capital markets compelled the World Bank and other multilateral agencies to raise interest rates on their loans. Finally, rising interest rates also raised the cost of credits extended to purchasers of machinery and equipment.[27] Despite these increased costs for development loans, the World Bank's report for 1971 declares that "inappropriate terms have not usually been the cause of debt servicing difficulties." [28]

5. The position of the United States with respect to debt servicing is perhaps best illustrated by comparison with those of the other members of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD). Under the 1969 Supplement to the 1965 Terms Recommendation of DAC, there are two suggested criteria for the extension of loans and grants to the developing countries. The first, the so-called grant test, requires that a minimum of 70 percent of total official development assistance be in the form of grants. The second, which concerns loans, consists of a minimum concessional element test and an average concessional element test. The minimum concessional element test provides that transactions having a minimum grant element of 61 percent should constitute at least 85 percent of total official development assistance. The average concessional element test provides that the softest 85 percent of official development assistance commitments must contain an average grant element of 85 percent.

In 1969 the United States finally met the grant test, which had been prescribed in 1965, but a year later it had fallen short again. Only 64 percent of official U.S. development assistance was in the form of grants. The percentage figures for certain other countries were as follows: Australia, 91 percent; Canada, 65 percent; France, 73 percent; Germany, 54 percent; Japan, 39 percent Norway, 99 percent; and the United Kingdom, 50 percent.[29] The United States qualified handsomely, however, under both the minimum and average concessional

[27] *Partners in Development*, *op. cit.*, pp. 153–154.
[28] World Bank/IDA Annual Report. 1971, *op. cit.*, p. 54.
[29] Organization for Economic Cooperation and Development. Development Assistance. 1971 Review, *op. cit.*, p. 64.

element tests, showing 92 percent of grants and loans with a concessional element of at least 61 percent, and a 92 percent concessional element in the softest 85 percent of official assistance. Comparable figures were 98 percent for Canada in each category, 84 percent minimum and 86 percent average concessional elements for Germany, 73 and 93 percent for France, and 88 and 90 percent for the United Kingdom.[30]

Viewed in this manner, the United States' contribution to development aid appears in a much more generous light than when compared with other countries on the basis of GNP alone. Yet it has been pointed out by at least one authority that most other bilateral donors lend on terms which on the average are softer than those by the United States.[31] For one thing the terms of commodity assistance under P.L. 480 have been progressively hardened by the Congress. First, Congress increased the requirements for down payment on sales, and then it increased the proportion of local currency proceeds reserved for U.S. uses. Then the repayment of loans from the proceeds of P.L. 480 sales was gradually converted from a local currency basis to a dollar basis. Export-Import Bank loans, which were generally extended on tougher terms than those advanced by the Development Loan Fund of AID, increased significantly as a vehicle of economic assistance. Grants tended to exceed credits for military assistance by a considerably greater margin than was the case with economic aid. These factors, along with a general increase in interest rates and strengthening of other conditions attached to dollar loans, added up to a very definite hardening of U.S. bilateral assistance terms.[32]

By way of contrast, some, but not all, of the other bilateral donors were gradually easing their terms while the United States was tightening up. Canada, Denmark, the United Kingdom and Sweden introduced interest-free loans. In recent years more than half of Canada's loan commitments have consisted of 50-year maturity interest-free loans. On the other hand, hard lenders such as Germany and Japan have become increasingly important to the overall flow of aid, and the practice of tied aid has become almost universal. Even those multilateral agencies which borrow in the world's money markets, faced with the tightness of markets and anticipating the need to raise more capital by floating bonds, have generally hardened their terms. What is more, the harder-lending agencies such as the World Bank or the Inter-American Development Bank, have been making an increasing proportion of development loans. If such institutions issue bonds to replenish their loan funds they may have to pay more to attract investment, with the result that they will charge the borrower more. In the meantime soft loan agencies such as the International Development Association, (IDA) the U.N. agencies, and specialized funds of the regional banks, which depend on governments for their source of funds, have been finding the going ever harder as they seek to obtain the wherewithal to expand their operations. Furthermore, some multilateral agencies have actually gone in for tied aid. For example, the European Economic Development Funds now require that the funds it provides can be used for purchases only in member or associated

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30 *Ibid.*

31 Frank, Charles R. Jr., Debt and Terms of Aid. Washington, D.C. Overseas Development Council Monograph No. 1, 1970, p. 9.

32 *Ibid.*

countries of the European Economic Community; and U.S. subscriptions to the IDA have been tied to procurement in this country.

B. WHAT CAN THE UNITED STATES DO?

It is in the interest of developing countries with major debt servicing problems and in the interest of their creditors that steps be taken to provide alternatives to the present situation. Moves toward untying aid may best be undertaken in concert, as has previously been pointed out,[33] but there are measures that the United States can undertake unilaterally without giving undue offense to other donor countries.

1. One alternative course for the United States, but one that would have to be described as a very remote possibility, would be to forgive certain development loans and simply turn them into grants. Assuming this highly unlikely course of action were adopted—which would appear to require congressional approval—U.S. aid officials would be called upon for decisions as to which loans to forgive. Even if they exercised such a power with the utmost tact and discretion, it is difficult to see how a great deal of protest and recrimination on the part of those developing countries who were not afforded this kind of relief, could be avoided.

2. A more likely alternative would be to reschedule payment of certain development credits. Such reschedulings are normally carried out in a multilateral context, and there have been twenty-four of them involving twelve countries between 1956 and 1972.[34] Among the more important reschedulings in which the U.S. has been involved are the following:

(*a*) the India Consortium, 1968 and 1971. In that case, the total relief was $100 million for each of these two years. The U.S. share was $8.8 million per year, covered by granting relief of debt servicing due on a loan made by AID predecessor. In April, 1972, the India Consortium agreed in principle to reschedule $151.4 million in debt service due. The U.S. share is to be $29.12 million, divided into $23.6 million in AID credits and $5.5 million in P.L. 480 Title I sales agreements.

(b) Indonesia: Earlier reschedulings were subsumed under a 1971 agreement by which Indonesia's pre-1966 debt was rescheduled on a 30 year repayment basis. The total amount rescheduled was $2.1 billion, of which the United States' share was $213 million.

(c) The Pakistan Consortium agreed in March, 1972, to reschedule some $234 million of debt service due in the period between March and June 30 last year. Repayment is to be made over a three year period beginning on June 30, 1974. The United States share of this rescheduling is $50.1 million.

(d) Chile: Thirteen Western creditor nations, the so-called Paris Club, have agreed in principle to reschedule payment of an estimated $160 million, on which Chile has been in default since November 1971. Repayment is now supposed to be made over an eight year period. According to AID, "Bilateral agreements concerning the U.S.

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[33] See pp. 31 and 33.

[34] U.S. National Advisory Council on International Monetary and Financial Policies. Annual Report covering period July 1, 1971–June 30, 1972. Washington. U.S.G.P.O. December 1972, p. 33.

share of $65 million pursuant to the agreed minute signed by the creditor nations have not been completed."[35]

(e) Yugoslavia: In August, 1971, the United States and Yugoslavia signed an agreement in conjunction with an International Monetary Fund "standby" which rescheduled some of the principal and contractual interest falling due during calendars 1971 and 1972. The amount rescheduled was $59 million, to be repaid over ten years after a 1 year grace period, at a 5 percent annual interest.

(f) Egypt: After a four year default, Egypt and the United States reached an agreement to consolidate and reschedule Egypt's debts to AID, the Export-Import Bank, the Commodity Credit Corporation, and the Agriculture Department. A total of $145 million was rescheduled.

Assuming a satisfactory agreement is reached with Chile, the total amount of the United States share of debt reschedulings will be $578.82 million. While there have been other debt reschedulings to which the United States has not been a party, since the United States is by far the largest creditor of the developing countries, the largest amount of rescheduled obligations involved debts owed this country. It is anticipated that problems of debt servicing will be exacerbated in the 1970's, as the grace periods terminate on loans made during the 1960's, when there was a high level of development lending.

One ironic aspect of the situation is that different U.S. agencies lend on different terms, so that whether or not a debtor country seeks to reschedule payments may be a function of the type of loan that was originally negotiated. Development loans of the Agency for International Development are usually made at the minimum terms permitted under the Foreign Assistance Act, namely 40 years maturity, 10 years grace, 2 percent interest during the grace period and 3 percent thereafter. Loans under P.L. 480 are made on harder terms, and those made by the Export-Import Bank are harder still. The result is to increase the difficulty of correlating the loans and credits advanced to any given country with its capacity to service the debt thus incurred. It has been suggested that some flexibility could be achieved in matching terms to debt servicing capacity if AID, the Department of Agriculture, and the Export-Import Bank would coordinate their policies with respect to the terms to be offered each recipient country.[36] In any event debt negotiation is likely to play an enhanced role in the arithmetic of U.S. bilateral and multilateral development aid, and it is important for this country to develop policy guidelines with respect to such matters as flexible terms, burden sharing, and resource requirements of the LDC's.

Congress would undoubtedly wish to take part in the formulation of any new policies in this area, particularly with respect to the terms of lending, a subject concerning which it has a wealth of experience and expertise. It would be possible for Congress to exercise ultimate control over the terms of aid yet permit AID to have considerable flexibility. For example, Congress could place one ceiling on the total amount of loans and another ceiling on the total amount of concessional aid, while the aid agency could determine the composition of

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[35] Extract of document in preparation, submitted to writer by Office of Legislative and Public Affairs, Legislative Programs Coordination Staff, AID.

[36] Frank, Charles R. Jr., *Debt and Terms of Aid, op. cit.*, p. 41.

assistance to a particular country within those particular limitations. Or flexible terms with respect to interest rates, maturities, and grace periods could be enacted into law. In any event, there are strictly unilateral options with respect to debt servicing and rescheduling that are open to the United States should this country care to use them.[37]

3. Other courses of action involve acting together with other donor countries. Among the alternatives which lend themselves to a cooperative international approach are the search for methods that would increase the adaptability of multilateral lending agencies. One way to accomplish this would be to increase greatly the funds available to the soft-loan agencies, while another might be some form of interest subsidization. The U.S. could also work through DAC to work out a burden sharing criterion that is more equitable than the present "terms recommendation."

Any leverage the United States can exercise toward inducing its fellow donors to work together toward injecting greater flexibility into the terms of bilateral aid, or toward grouping receiving countries according to their debt-servicing ability, or toward increased subscriptions to multilateral lenders, particularly those of the soft-loan variety, is obviously circumscribed by the harder lending terms this country has imposed in recent years, and by the delays in meeting U.S. quota payments to the International Development Association and some of the regional banks. If the United States feels that these objectives are worth attaining, and would like to use its influence toward their attainment, then it would seem desirable that it ease repayment terms on loans and credits, and be somewhat less grudging in redeeming pledged subscriptions.

a. At the UNCTAD Conference at Santiago the United States took a somewhat equivocal position toward a poor nation proposal linking Special Drawing Rights (SDR's) of the International Monetary Fund to development assistance. At first it appeared that the United States would endorse the measure, but then it backed off, arguing the decision was one for the IMF to make, and abstained from voting on the resolution.

Special Drawing Rights are a form of bookkeeping technique by which the IMF puts about $3 billion into circulation annually. They are used as a means of settling debts between countries. But some 73 percent of this so-called "paper gold" goes to 25 of the rich nations of the IMF, while the remaining 27 percent goes to 86 poor nations that are also members of the Fund.[38] What the developing nations want is a distribution scheme which will enable them to utilize the SDR's as a source of funds to service their debts for development loans and credits, instead of their being used by the deevloped countries chiefly for meeting short-run declines in foreign reserves, as is presently the case. SDR's could constitute a form of pump priming which would not obligate the LDC's to depend upon the good will and largesse of the lending nations and their legislatures.

Dr. Hannah, the Administrator of AID, has stated, with respect to this use of FDR's, "If we are to carry out our fair share of the total

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[37] The Rockefeller Report, "Quality of Life in the Americas" suggested that when a debt is postponed for a period of years the equivalent amount in local currency be paid to a fund to be used for development. The United States was to have some influence on this fund.

[38] Congressional Record, Apr. 13, 1972, p. E-3748.

responsibility, I see no better way to do it." [39] The Spokesman for the Common Market Finance Ministers, Sr. Colombo of Italy, indicated that his group were agreed that SDR's should be used as an indirect form of development assistance. Yet when it came to a vote at UNCTAD III the United States, Britain, West Germany, France, and other capital exporting countries abstained from voting for a simple resolution urging the IMF to consider all aspects of various proposals for a link between the SDR's and development asssitance.[40] This apparent indifference to what the developing countries see as an overwhelming need served to heighten their frustration and aggravate their resentment at the developed countries, particularly the United States. Indeed, the outcome of UNCTAD III in this and other areas does not augur well for future relations of this country with the underdeveloped world.

4. In considering the debt servicing problems of the LDC's it needs to be borne in mind that a great deal of this debt is owed to private creditors. According to the World Bank, of the total public debt outstanding at the end of 1969, 26.4 percent was owed to private creditors (more, incidentally, that was owed to multilateral institutions and regional developmental banks). In addition, the loans extended by private creditors normally have somewhat shorter repayment periods than those extended via official agencies.[41]

Obviously the government cannot change the terms of loans extended to developing countries by private lenders. But it can throw its influence behind unofficial efforts to persuade private U.S. creditors of the LDC's to reschedule and renegotiate loans, lower interest rates, and lengthen periods of repayment. Such a course is more likely to be pursued if the government, as a matter of policy, adopts a generally permissive attitude toward those LDC's desirous of easing the terms of repayment on officially-extended loans and credits. Congressional sentiment can have a great deal to do with any decision by the executive branch on whether to ease such terms or to insist on strict observance of the original obligation.

5. Preferential treatment for the products of the less developed countries in the markets of the developed ones, specifically in the U.S. market, has been very widely advocated as a remedy for the debt-serving difficulties of the assisted nations. Such treatment would presumably permit the LDC's to earn the foreign exchange to meet their external obligations, including loan payments. However, the use of preferences is in itself a major alternative policy to the present bilateral aid program, and as such deserves to be discussed for many reasons in addition to its applicability to the debt problem. The next section of this report is devoted to preferential tariffs, and their feasibility as a technique for dealing with the mounting debts of the LDC's will be treated therein.

6. One other approach toward mitigating the debt problem which has already been alluded to in this report would be the untying of aid. At present there is little sign of movement on this issue. A resolution was passed at the recent UNCTAD meeting which urged the devel-

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[39] Quoted in Congressional Record, Apr. 28, 1972, P.S. 6949.
[40] New York Times, May 22, 1972, p. 2.
[41] World Bank/IDA Annual Report. 1971, *op. cit.*, pp. 51–52.

oped countries to reach an international agreement on the general untying of aid at the earliest possible date.[42] If past performance is any guide, it will not have much of an effect on the developed countries. This could be unfortunate, for either the inability or unwillingness of the developed countries to respond to much of what the LDC's consider to be their justified demands appears to be producing not only a scepticism toward the sincerity of the developed countries, but a restlessness which has the potential to become a seriously destabilizing element to current world order.

[42] United Nations Monthly Chronicle, June 1972, p. 46.

IV. The Question of Preferential Tariff Treatment

A. THE POSITION OF THE LDC'S

Preferential treatment for the goods of the LDC's in the markets of the developed countries is probably the most widely advertised panacea for the problems of the developing countries. Trade brings in foreign exchange earnings, while aid does not. "In the long run," says the Pearson Report, "only the evolution of their trade with other nations, together with a growing capacity to substitute domestic production for imports, will enable the developing countries to grow without the help of concessional finance." [43] In essence, the drive for preference is a move to substitute what might be called concessional trade for concessional finance.

Not surprisingly, the LDC's view the question of preferential treatment for their products as crucial. Without a consistent flow of exports it is difficult if not impossible to make firm development plans. Indeed, the economic growth of individual developing countries correlates more closely with their export performance than with any other economic indicator.[44]

1. The developing countries have, on a number of occasions, expressed their concern over their trading outlook, and their interest in gaining access to the market of the developed countries on preferential terms. (They actually have succeeded in doing so in a number of countries, a matter discussed under subhead B below). At UNCTAD I, held in 1964, the LDC's argued for general preferential tariff treatment without any quid pro quos, receiving the support of the United Kingdom, while France and Belgium favored selective preferences. The United States, Canada, Norway, Sweden, and Japan opposed preferences altogether at that time. At UNCTAD II, in 1968, the less developed countries reiterated their demand, and by this time the United States was ready to agree to it in principle. In 1969 the Latin American countries brought out the Consensus of Vina del Mar, which while aimed essentially at the United States, forcefully articulated the measures the LDC's wanted the developed countries to take in the trade field. Two of the key principles would (1) eliminate the concept of reciprocity whereby any participating country (in a general tariff agreement) was expected to make concessions equal to those it receives, and (2) modify the principle of non-discrimination, under which each participating country would be expected to treat all others alike. Where the Consensus went further than other statements of this type was in its proposal that the United States might select sectors or branches of its own economy where the production pattern could be restructured to create a market for Latin American manufactures and semi-manufactures.[45] At the last UNCTAD meeting the demand for

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[43] *Partners in Development, op. cit.*, p. 80.
[44] *Ibid.*, p. 45.
[45] Thorp, *The Reality of Foreign Aid, op. cit.*, p. 279.

preferential status was voiced again by the developing nations, but the thrust of the conference seemed to be more towards coaxing additional funds out of the developed nations and linking Special Drawing Rights to development assistance. Nevertheless there is no indication that the LDC's are prepared to abandon their case for special measures to help them increase their foreign earnings, which they have pressed at so many conferences over the years.

a. The idea of extending preferences to the exports of the LDC's is contrary to the concept of reciprocity originally embodied in the General Agreement on Tariffs and Trade (GATT). However in 1964 a new chapter was drafted which was subsequently added to the Agreement. Among other provisions were the following:

> The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.
>
> The adoption of measures to give effect to these principles and objectives shall be a matter of conscious and purposeful effort on the part of the contracting parties both individually and jointly.

It was under these provisions that some developed countries have extended preferences to the LDC's, a subject to be discussed under subhead B 1 *infra.*

Preferential treatment for the LDC's also runs counter to the widely accepted theory that the most efficient use of economic resources on an international scale can be made only when goods can flow freely across national boundaries.[46] The trade policies of the developed countries tended increasingly to accept this philosophy, which culminated in GATT. The demand of the LDC's runs counter to this philosophy and this trend, not so much for raw materials, many of which are produced only in the less developed countries, but rather for manufactured and semimanufactured goods.

2. The less developed countries are also concerned that despite increases in their export earnings, they have actually been losing ground in the battle to gain a fair share of the world's trade. During the 1960's, for example, the earnings of the LDC's derived from their exports to developed countries increased by 6 percent, but the volume of world trade increased even more, so the LDC's actually fell farther behind.[47] Between 1962 and 1969 the developing countries managed to increase their exports of manufactured goods at an annual rate of 15 percent. However, they started from such a small base that these exports have not managed to exceed 5 percent of the manufactured imports of the developed nations, and only one third of 1 percent of the latters' gross national product.[48] According to Robert S. McNamara, President of the World Bank, a 15 percent rate of growth in manufactured exports will be more difficult for the LDC's to achieve in the 1970's than it was in the 1960's. In the preceding decade such exports rose from less than $2 billion in 1960 to $7 billion in 1970, but they would have to quadruple to $23 billion by 1980 to maintain the 15 percent rate of growth. On the assumption that this goal were reached,

[46] There are challenges to this theory however. Paul Bairoch, writing in *Ceres* gives data to indicate that the economic expansion of the industrialized countries often coincided with protectionist policies. "Free Trade: Myths and Realities." Ceres, FAO. Review. Mar.–April 1972, pp. 17–19.

[47] Pearson Report, *op. cit.*, p. 45.

[48] McNamara, Robert S., Address to the Governors of the World Bank Group. Sept. 27, 1971. Washington. 1971, p. 25.

the total volume of manufactured goods exported from the developing countries would still amount to only roughly 7 percent of projected imports of manufactures by the developed countries, and only 1 percent of their projected GNP.[49] It is projections such as these which impel the developing countries to seek preferential treatment.

a. The developing countries have also complained that the terms of trade have been against them—that is, the prices of their imports rose more than the prices of their exports. This has meant increased foreign exchange expenditures relative to foreign exchange earnings, resulting in an adverse impact on development, according to the LDC's. Many economists do not accept this contention, however, arguing that statistics adduced in support of it are subject to variation depending on the period used, the goods whose prices are being compared, changes in quality, and different allowances for shipping costs. Assuming these criticisms to be valid, the fact remains that the developing countries tend to cling to a belief that they are victimized in the terms of trade, and this belief is one of the components fueling the demand for generalized preferences.

b. As raw materials producers, many LDC's have been particularly vulnerable to fluctuations in world commodity prices. Some of these countries now find that vulnerability increased due to competition from synthetics produced in industrialized countries, and from competing raw materials produced in some developed countries assisted by tariff protection or some other form of subsidy.

No attempt will be made here to go into the complexities of the international commodities markets, or the international arrangements that have been made to introduce a modicum of stability into the production and marketing of some raw materials which lend themselves to such regulation (Vide the International Coffee, Wheat, and Tin Agreements, for example). Suffice it to say that the difficulties encountered by the LDC's as raw materials producers have been another element underlying their demands for preferential treatment by the developed countries. Yet as Streeten points out, in asking for preferential treatment for their raw materials, the LDC's are, in effect, asking for the perpetuation of their status as raw materials suppliers, which is contrary to the broad strategy adopted by so many developing countries of "import-substituting industrialization behind protective barriers." [50] But this kind of conflict does not crop up with respect to the demands for preferential treatment of the manufactures and semi-manufactures of the LDC's.

Some economists have criticized the whole import-substitution strategy and what they regard as the obsession of UNCTAD and the developing countries with preferences and commodity agreements.[51] In their view the developing countries should concentrate on building up indigenous technological and managerial skills, as a means of freeing themselves from dependence on the developed countries. It is through the acquisition of such skills, the argument runs, that the LDC's will be able to take independent advantage of trade and investment opportunities as they arise. However, the prevailing view continues to focus on the need for preferences.

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[49] *Ibid.*
[50] Paul Streeten, "Terms of Trade Are Not Made on Paper." Ceres, *op cit.*, p. 34.
[51] *Ibid.*, p. 38.

3. The emphasis on preferences assumes as a corollary that the developing countries themselves will pursue export-stimulating policies. The whole concept of development through trade collapses if the underdeveloped countries pursue policies which discourage or choke-off their exports. Unfortunately certain actions of some of the underdeveloped countries have had that effect. Some major exporters of cereals have become importers because they neglected their agricultural development. Chronic inflation coupled with overvalued exchange rates which failed to keep up with rising prices have been particularly harmful in Latin America. Local entrepreneurs have not moved resources into new lines of production in time to take advantage of export opportunities. Sometimes this is the result of a natural preference to continue producing high cost protected import substitutes. In any event, prevailing doctrine holds that an important element in measuring the seriousness of an LDC's commitment to development lies in its willingness to promote its export trade.

B. TRADE POLICIES AND PROBLEMS: THE UNITED STATES, OTHER DEVELOPED COUNTRIES, AND THE THIRD WORLD

1. It should not be surprising, given the propensity of nations to look at the world through the prism of national interest, for the United States and the countries of the third world to have rather different assessments of U.S. trade policies as they relate to international development. The developing countries contend that U.S. tariff policies offer them little encouragement. They contend that the United States is tardy and indifferent for failing, thus far, to adopt a broad system of preferences. They argue that our non-tariff barriers discriminate against their raw materials such as cotton, copper, and petroleum, and also against their manufactured or semi-manufactured goods such as textile products, leather goods, and processed meats, fruits, and cereals. In addition, they criticize U.S. concessional trade financing, contending they can often get better terms elsewhere. They also point out that our "buy American" rules for U.S. Government procurement bestow an advantage on domestic suppliers for commodities that they (the LDC's) might sell to our government more cheaply.[52]

The State Department and other government representatives usually counter these allegations with references to U.S. willingness to participate in a general system of tariff preferences for developing countries. They point to the fact that the United States has accepted the idea of preferential treatment for LDC products in principle, and they assert that a healthy export position for the developing countries is one of the goals of the U.S. foreign aid program. These generalized responses can hardly be expected to arouse the enthusiasm of the developing countries, and they do not. The latter contend that the United States has made commitments to UNCTAD and various organs of the Inter-American System to put into effect a system of generalized preferences for the developing nations. They would like to see these pledges implemented by legislation establishing such preferences and abolishing quotas and domestic subsidies.

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[52] Keith E. Jay, Tariff and Non-Tariff Barriers to Trade With Developed Countries. Development Digest, vol. V, No. 3, July 1972, p. 87.

2. Among the developed nations Australia, Japan, and virtually all of Western Europe have established the so-called generalized system of preferences. That system, which is actually something of a misnomer, grew out of both UNCTAD and OECD deliberations. The United States of submitted a proposal to the OECD in July 1969 which called for the following: [53]

A. The elimination of duties on manufactured and semi-manufactured goods from the LDC's, with the exception of textiles, footwear, and petroleum and petroleum products. Selected agricultural and fisheries products would also benefit from preferential treatment.

B. The elimination of quantitative limits on additional imports eligible for preferential treatments. Injury to domestic produces would be met via escape clauses and adjustment assistance.

C. Preferences were to be temporary, to last no more than ten years, and were not to obstruct further general tariff reductions.

D. All leading developed countries would adopt a common plan.

E. The United States *would not* grant preferences to any country that received an exclusive trade preference from any developed country for a product covered by the plan, nor would it grant preferences to any LDC that gave exclusive trade preferences to any developed country.

This last point was aimed at the Yaouade Convention, agreed to in 1963 and renewed in 1969, between 18 African countries, most of them formerly French colonies, and the Common Market. Under that Convention duty free preferences were accorded by the Market to the LDC's involved, but reverse preferences were also given to the Market countries.

Other differences between the United States and the European Economic Community cropped up late in 1969 when 18 industrial nations submitted suggestions to UNCTAD for eliminating tariffs on a wide range of commodities. The United States proposed most-favored nation treatment for all the LDC's but wanted textiles, footwear, and petroleum excluded from such privileges. The U.S. plan also included an escape clause should undue hardship result from increased imports. The Common Market, on the other hand, proposed a quota system. Under its provisions, goods from the LDC's would enter duty free, up to the limit of the quota. But the Market also required that preferred treatment be continued for the African countries which already enjoyed it. The Japanese proposed certain limits on tariffs reductions, while Britain and the Scandinavian countries favored a broader system of preferences. These difficulties have not been reconciled, so that different countries offering preferential treatment to the LDC's use their own systems, which are supposed to afford concessions that are roughly similar.

a. This background ought to be borne in mind when discussing preferences that other nations have extended to the LDC's. For although the United States has not yet taken such action, the preferential systems of some of the developed countries may not actually do much to stimulate either the trade or investment that the LDC's need

[53] Thorp, Willard, *The Reality of Foreign Aid, op. cit.*, p. 283. Italics added.

for steady development. The Common Market's plan of generalized preferences introduced in 1971, for example, offers duty-free entry for all manufactures of developing countries (except Taiwan) up to a specified quota limit. But any LDC manufactures imported by an EEC country above that ceiling will require the payment of the regular most-favored nation duty. A list has been drawn up of so-called "sensitive" commodities—that is, those where domestic industry might be adversely affected by competition from the underdeveloped countries—and no single developing country is entitled to more than half the total quota for each such commodity, and in some cases no more than twenty or thirty percent. Furthermore, quotas are based on data taken from past years and do not take account of recent rapid growth in exports from the LDC's without any system of tariff preferences.[54] Thus if duty-free exports have overtaken the original quota, any additional exports from a less developed country must pay full duty. In addition, as Richard N. Cooper points out, the EEC plan is most accommodating for those products in which the developing countries stand virtually no chance of being competitive, such as jet aircraft or advanced computers.[55] Conversely it is most restrictive for those commodities which the LDC's are currently exporting in volume.

Special restrictive treatment for textiles and footwear is another feature of the Common Market's preference system. In addition, the Market has no machinery for applying quotas throughout the Community, which means they must be applied by national authorities who may employ differing methods to enforce them. The results, from the standpoint of the LDC's, can frequently be inequitable. All of these factors have led Cooper to conclude that rather than being a "generous response" to the needs of the LDC's, as the ECC self-servingly proclaimed, the Community's preference system will provide only a negligible stimulus to development.[56]

b. If the Community's scheme for tariff preferences on LDC manufactures falls somewhat short of what the latter desire, the developing countries must also be disturbed by the growing protectionist trend of the EEC with respect to agriculture. The EEC is presently undergoing the kind of technological advance that U.S. agriculture experienced several decades ago, with the concomitant reduction of the agricultural labor force. The Community has tried to meet problem under its common agricultural policy through the adoption of highly protectionist measures. Developing countries have thus been thwarted in their hopes of expanding the markets for their agricultural produce within the borders of the EEC. This situation may change in time, as both developing and developed countries adapt to the new situation, but for the present it definitely constitutes a setback to the development plans of many LDC's.

3. Unfortunately from their standpoint, the LDC's disappointment is not assuaged by current protectionist pressures in the United States. For example, in the first few months following the Kennedy Round Agreement at Geneva in 1967 almost 1,000 trade bills were introduced in Congress seeking protection for products ranging from honey to

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[54] Richard N. Cooper, The EEC Preferences: A Critical Evaluation, Intereconomics, No. 4, 1972, pp. 122.
[55] *Ibid.*, p. 123.
[56] *Ibid.*, p. 124.

man-made fiber textiles, from mink furs to electronic equipment. These bills would have applied protection to imports whose values in 1966 had been more than $6 billion, or almost one-fourth the total value of all imports into the country. They generally provided for quotas rather than duties. During the remainder of the 1960's additional protectionist legislation was proposed, but none was passed.

Pressures for protection of American industry culminated in S. 2952, the proposed Foreign Trade and Investment Act, of the 92d Congress. This proposed law sets up quotas on *all* imports, except where there is voluntary government-to-government agreement, or where existing law already imposes quotas, or where failure to import certain goods would cause long-term disruption of U.S. markets (e.g. coffee, tea, bananas, and other goods not produced in this country), or finally, where competing domestic industry has consistently failed to modernize. Quotas would be equal to average annual imports during the periods of 1965–1969, with mandatory changes authorized as U.S. production rose or fell, so that the amount of a particular commodity imported would continue to be in the same ratio to domestic production as existed in 1965–1969. Among the many other provisions of the proposal is one which provides that the President's reports on foreign assistance are to include a detailed review of the extent to which projects financed under any foreign aid program are exporting their output to the United States, and the extent to which prohibitions against furnishing assistance to certain countries have been complied with. At the time of this writing no hearings had yet been held on this bill.

Although protectionist pressures seem to be on the increase in the United States, they have arisen primarily in response to the actions of other developed countries, and have been directed essentially at those countries. But the LDC's stand to lose as well, insofar as these proposals might affect textiles, for example, or other light manufacturer and processed goods. In a sense S. 2592 was aimed at some developing countries, such as Korea, Hong Kong, and even Taiwan (if that can still be called a developing country), where U.S. firms have invested heavily, and whose products, especially textiles, are shipped to this country in quantity where they are in direct competition with the American product. Furthermore the provision of S. 2592 cited above which requires the President to report on exports to the United States arising from aid projects while not restrictive in itself, could be interpreted as implying that if such exports reach a substantial volume either the aid will be cut back or the exports in question will be subject to all applicable barriers. Neither inference is likely to encourage development.

4. Developing countries are also penalized by the fact that whether U.S., or foreign, tariffs tend to increase with the degree of processing. Tariffs on raw materials are low, sometimes actually zero. Duties on partly manufactured goods are higher, and those on finished manufactures higher still. The end result is that the LDC's often find that there is no export market for their manufactures, and not much more of a market for processed and semi-manufactured commodities. Obviously little stimulus to development is afforded by this situation. Should a particular industry in a developing country reach a state of efficiency

where its products manage to surmount tariff walls and compete with industry in more advanced countries, governments of these developed countries quickly come under pressure to counter such competition, and often yield to it. For many less developed countries, however, the duties or non-tariff barriers employed by the developed countries are academic, as they are simply unable, at this time, to compete effectively in foreign markets.

5. It has been pointed out earlier that there are now provisions in GATT which permit the establishment of generalized preferences. At the same time the ideal of GATT, and presumably of U.S. foreign trade policy as well, is to promote freer trade in goods and services, and the broad non-discriminatory reduction of tariff barriers. The instrument for that purpose has been the most favored nation clause, which is incorporated in GATT and has not been superseded by Part IV. The latter, according to John H. Jackson, is more in the nature of a statement of principles than a set of legal obligations.[57] Thus the United States faces something of a dilemma. On the one hand it has committed itself to establish a system of preferences in favor of the LDC's, while on the other hand it is committed to most favored nation treatment for all. Some developed countries have solved a similar problem simply by abandoning the most favored nation concept. How the United States will resolve this dilemma remains to be seen. It seems unlikely, however, that this country will adopt a system of preferences as discriminatory as it has repeatedly claimed those of the EEC to be. In any event, a decision in this matter faces the United States as it contemplates the future of its trade and aid policies.

C. TRADE AND DEVELOPMENT: SOME POLICY CHOICES

1. A number of ways have been suggested by which the United States can use trade policy to improve the situation of the developing countries. One of these suggestions involves pressing for a broader range of international commodity agreements, as those currently in effect cover only a limited number of commodities. The advantage of commodity agreements, from the standpoint of development, is that they are presumed to make for stabilized prices for specific commodities upon whose export certain developing countries may be dependent. With stabilized export prices those LDC's participating in an agreement can calculate their foreign exchange earnings with a substantial degree of accuracy, and can thus make relatively firm development plans.

However, in practice the record of commodity agreements is less than heartening. For example, the International Wheat Agreement sets minimum and maximum prices, but has no export or production controls, and proved unable to maintain prices during periods when stocks were increasing. A five year International Sugar Agreement which went into effect in 1969 (with neither the United States nor the Common Market as members) leaves the regulation of supplies in the hands of the members.

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[57] Jackson, John H. "World Trade and the Law of GATT," New York, Indianapolis, Kansas City, Bobbs-Merrill, 1969, p. 646.

The questionable results of commodity agreements led a Senate subcommittee to conclude the following in 1967:

> The subcommittee is inclined to regard international commodity agreements as a dubious means of increasing the flow of resources to less developed countries. . . .[58]

Instead the subcommittee suggested that the improvement of marketing methods would be likely to yield at least as good results for short-term stabilization, and it saw long term stabilization as unlikely to be achieved via commodity agreements. Rather than encouraging the conclusion of additional commodity agreements, the United States, in the subcommittee's view, should urge the LDC's to promote the diversification of their industries. The corollary of this, as the subcommittee saw it, was to add investment and technical assistance to LDC self-help and to whatever aid might be furnished by other industrialized countries.

2. In recommending that the LDC's be encouraged to diversify, the subcommittee put its finger on another method of assisting developing countries. For the export opportunities of the developing countries would seem to be necessarily limited as long as some seventy-five percent of those countries earn at least 60 percent of their export income from no more than three commodities.[59] However, it is difficult to encourage the poor nations to diversify if they have no assurance that there will be markets for their new products. This brings us back to the question of preferences once again. Furthermore, as the subcommittee pointed out, diversification is going to require investment, and it would be inconsistent for the United States to urge diversification on poorer nations without being prepared to assist in that process. Other developed nations could no doubt be prevailed on to help the LDC's diversify, but the crucial point is that in the short run, at least, diversification does not obviate the need for capital assistance to which the United States would be expected to contribute its share.

3. This country can always exercise the alternative of keeping and even strengthening existing tariff and non-tariff barriers to the exports of the poor countries. This would presumably have a negative effect on economic development. The United States would probably find itself pressed to make up for any drop in LDC export earnings by extending increased development assistance. But this pressure would be more external than internal, and it seems unlikely that it will evoke the desired response. If no additional assistance is forthcoming, however, the combination of strengthened barriers to trade, and reduced outlays for foreign aid, could signal the further erosion of the U.S. commitment to development.

4. Another option open to the United States is to encourage coordinated efforts by the LDC's, usually through regional organizations, to enlarge trade among themselves. In so doing we have to be prepared

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[58] U.S. Congress, Senate, Joint Economic Committee, Subcommittee on Foreign Economic Policy. The future of U.S. foreign trade policy. Report with supplementary statement and individual views. 90th Cong., 1st sess. Joint Committee Print. Washington, U.S. Government Printing Office, 1967, p. 14.

[59] Malmgren, Harald and Joe Kimmins, "World Trade: Engine for Global Progress." Overseas Development Council. Communique on Development Issues, No. 1. Washington, 1972. Third page of unnumbered foldout.

to contend with a good many difficulties, not the least of which is the protectionist policies the developing countries tend to follow toward each other. In addition, transportation and communications facilities between the LDC's are usually inferior to those linking them with the rich nations. In the same way, the instruments of finance and marketing are attuned to facilitating trade between the developed and less developed countries, but not among the latter. Overvalued exchange rates often hamper LDC efforts to compete with the more developed nations. Concessional loans by the more developed nations have enhanced the difficulties of the LDC's in selling their products to their fellow low income countries. This has been particularly damaging in the case of agricultural commodities. Accustomed to foreign exchange shortages and balance of payments difficulties, the LDC's tend to concentrate on the importing of raw materials and capital goods from the advanced economies when foreign exchange is available, and the practice of tied aid makes it quite difficult for them to do otherwise, particularly with respect to capital goods.

Nevertheless the Pearson Commission saw a great potential for trade expansion among the low income countries. It points to the fact that in 1966 the LDC's imported from non-Communist developed countries some $4.2 billion worth of food, $2 billion of textiles and clothing, almost $11 billion of machinery and transport equipment, and $7.6 billion of other manufactures. "They should clearly be able to sell a great deal more of these things to each other," says the Report.[60] It goes on to argue that the great diversity of natural resources and the differing stages of development among the LDC's "should ensure" naturally profitable trade in a broad range of products. Once incomes begin to rise in the LDC's, consumer demand for products of which they are already important suppliers can be expected to rise proportionately faster than in the developed countries. These products include a variety of foodstuffs, and simple manufactures such as textiles, bicycles, radios, and sewing machines. The Commission admonishes, however, that if the LDC's wish to attain these results they must put the same effort into facilitating mutual trade that they have into securing easier access for their goods in the richer country markets.[61]

The LDC's have taken some steps toward facilitating mutual trade and economic integration, but in the view of outsiders much remains to be done. Perhaps the most prominent of these LDC groupings is LAFTA, the Latin American Free Trade Area, which the United States has supported since its creation in 1961. However, LAFTA has not brought about the trade liberalization or accelerated development for which the proponents hoped, and the time for its transition to complete common market status was set back to 1980. Now there are hopes that the pace will be speeded up again, and that LAFTA will operate as a genuine common market, although many experts of Latin Amercia are inclined to view such a target date with skepticism. But while LAFTA bogged down, a number of its members, Bolivia, Chile, Colombia, Ecuador, and Peru, launched a subsidiary organization, the Andean Common Market, in 1969. That organization is now functioning as a true common market, with liberalized internal tariffs

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[60] Pearson, Lester B., *et al.*, *Partners in Development, op. cit.*, p. 92.
[61] *Ibid.*, p. 93.

and a single external tariff. On the other hand the Central American Common Market, which had functioned effectively since its inception in 1960, was thrown into disarray as a result of the so-called "football (soccer) war" between Honduras and El Salvador, to the point where there is some doubt as to whether it can any longer be characterized as a common market.

In Africa some governmental and intellectual leaders supported the idea of an all-African common market, linked to a movement for African political unity, against any attempts by the former metropolitan powers to exercise continuing *de facto* domination. But this idea never took hold, perhaps because of the unequal state of development of so many of the countries. Instead the Africans have instituted the East African Common Market, the Central African Economic and Customs Union, the West African Customs Union, the Arab Common Market, and the Economic Cooperation Scheme for the Maghreb countries (Tunisia, Morocco, Algeria, Libya).[62] Of these the most important is the East African Common Market, whose members are Kenya, Tanzania and Uganda. Although the East African Common Market was completely restructured in 1966 and 1967, its origins actually go back to the end of the first world war. The other bodies have begun operation only in the past few years, although in some cases preparatory work for their establishment got underway in the 1950's. Wionczek points out that there is a common characteristic to each of these arrangements, namely that "each is limited to a relatively small group of countries that, in addition to covering a compact geographic area, are united to some degree by common political or sociocultural traditions." [63]

Although each of these regional organizations is supposed to affect some degree of trade liberalization among its membership, the mechanisms designed to accomplish this purpose differ widely. Some involve full customs unions or common markets, while the so-called Arab common market, for example, is simply a limited free trade zone. Furthermore, trade liberalization is not considered to be the sole core around which regional cooperation is organized in most of these schemes. Cooperative regional industrialization is considered to be at least as important, because it is a way to industrialize and diversify more rapidly and directly, whereas reliance on the liberalization of the very small volume of trade among the LDC's for the sinews of economic development will be both drawn out and roundabout.

Cooperative regional industrialization is not without its pitfalls, however, the most dangerous of which involves distributing industries throughout the particular region in a way that all members can accept as equitable. This difficulty is recognized in the so-called Regional Cooperation for Development, involving Turkey, Iraq, and Pakistan. It centers its scheme for regional cooperation around an industrial integration program which would establish a number of mutually complementary industries distributed among the member countries in accordance with their resource endowments.

In addition to liberalized internal trade and equitable allocation (and hence benefits) of new industry, the chances for viable regional

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[62] Wionczek, Miguel S., *Economic Cooperation in Latin America, Africa, and Asia.* Cambridge, Mass. The MIT Press. 1969, p. 12.
[63] *Ibid.*

cooperation for development are enhanced, according to Wionczek, by the presence of a regional development bank and some regional mechanism to make financial settlements and coordinate monetary policy. operative effort began, which can have a decidedly negative effect on ities for harmonizing regional and external private investment, for promoting industrial specialization, and for equitably distributing customs revenues and other taxes, taking appropriate care to meet the development requirements of the least developed members. This last point is particularly important, for if the stronger economies within a region appear to be benefitting to a greater degree than the weaker, the latter may well feel more aggrieved than before the regional cooperative effort began, which can have a decidedly negative effect on that effort. Something along those lines took place in the case of LAFTA.

The establishment of the Inter-American Development Bank (IDB), the African Development Bank, and the Asian Development Bank is an indication of the growing utilization and growing acceptance of the regional approach to development. This is brought out in the charters of the banks themselves. While the charter of the IDB makes only a passing and indirect reference to financing regional collaboration, that of the African Development Bank states that special priority will be given to projects or programs that concern several members, and that of the Asian Development Bank makes it plain that the first claim on its resources will be reserved for those projects contributing to the harmonious economic growth of the region as a whole.

The United States, as a country in which "regionalism became almost an ideology * * * during the depression years,"[64] and which, in the TVA gave the world perhaps its most notable example of regional development, has generally given its support to collaborative regional development schemes, ranging from trade liberalization (LAFTA and the Central American Common Market) to integrated river basin development. Its involvement in the latter goes back at least two decades, when the U.S. Bureau of Flood Control and Water Resources Development did a study relating to flood control and water resources of the Mekong River for the U.N.'s Economic Commission on Asia and the Far East. In the Mekong Project, the U.S. contributed on both a bilateral and multilateral basis, along with 20 other countries, 12 U.N. agencies, and 7 private institutions. This was the situation when, in April 1965, President Johnson offered to ask Congress for $1 billion to finance a Southeast Asia development program, of which the Mekong Project would be the centerpiece. This offer, advanced at least partially in response to foreign and domestic pressures for a Vietnam settlement, was designed to suggest to Hanoi the advantages of reaching a peaceful settlement. It was made against the backdrop of increased bombing and the soon-to-be-revealed decision to send ground combat troops to the country, a classic example of carrot and stick diplomacy. The offer was brusquely rejected by Hanoi, and has not been renewed, although work on the Mekong Project still goes forward under U.N. auspices.[65]

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[64] Huddle, Franklin P., The Mekong Project: Opportunities and Problems of Regionalism. U.S. Congress. House. Committee Print. Committee on Foreign Affairs, Subcommittee on National Security Policy and Scientific Developments. U.S.G.P.O. 1972, p. 9.
[65] See New York Times, June 4, 1972.

Then in 1967 President Johnson enunciated U.S. policy with respect to regional economic development in terms that in general, if not in all specifics, would be applicable today. In his foreign aid message to the Congress that year he stated that "the United States will encourage regional economic development to the maximum extent consistent with the economic and political realities in each region."[66] The message takes note of the growing movement toward regional cooperation, which it sees as grounded in the facts of economic life, e.g. resources know no natural boundaries, rivers flow through many countries, sources of electric power must be shared by neighbors, and the like. It proposes a gradual shift in assistance to Africa to cooperative projects involving more than one donor and more than one recipient and participation in a special fund of the African Development Bank (despite the fact that as a non-African nation the United States is explicitly barred from membership in that Bank). The message also promises a favorable response to a request for special funds from the Asian Development Bank. This regional economic assistance is not conditioned on regional political unity. Instead it is justified in economic terms as making better use through joint action of the scarce resources available for development than would be made were those resources to be scattered among many countries.

U.S. support for regional development mechanisms does not mean equal support in all areas. Obviously certain areas are more suscepible to the regional approach than are others. Although the United States has supported the Latin American Free Trade Area, (LAFTA) for example, LAFTA's internal problems render it less promising than some of the smaller regional groupings in Africa. Moreover, to transform LAFTA into a Latin American Common Market would require assistance on a scale unlikely to be supplied by either the United States or the Inter-American Development Bank.

Actually the path of regional economic cooperation for development is not an easy one anywhere. Nevertheless many have come to believe, along with Wionczek,[67] that regional cooperation for development offers one of the few ways for the LDC's to break out of the cycle of "social backwardness, economic stagnation, and parochial nationalism." It does have certain advantages, such as emphasis on local participation in development and planning, the mitigation of strictly nationalistic objectives and sensitivities, and enhanced effectiveness of self-help. Its recognition that existing national states and their political subdivisions are not necessarily or even usually self sufficient economic units can make it possible for technology to be applied in a more coherent way to the problems of development, when the situation calls for it, than if such aid is applied within national borders alone.

But assistance to regional development schemes, whether they involve closer trade cooperation or the joint exploitation of natural resources, is not a panacea. It is simply another method of allocating development assistance funds. The regional approach does not go to the question of the sufficiency of available funds, nor does it guarantee the success of a particular project on which it is employed. This is the perspective from which the United States presumably views assistance

[66] Public Papers of the Presidents. Lyndon B. Johnson. 1967, vol. I. Washington. U.S. Government Printing Office. 1968, p. 166.
[67] Wionczek, Miguel, *op. cit.*, p. 29.

to regional groupings at the present time, a perspective which should also obtain in the future.

5. It has already been noted that tied aid reduces the amount of assistance actually transferred to the developing countries, and that such aid plays a major role in directing their patterns of trade as well. It was also pointed out that in permitting the LDC's to use their dollar credits elsewhere in the underdeveloped world the United States did not make a great contribution to their welfare, since the developing countries could not find much to purchase elsewhere in the third world that would be useful from a development standpoint.

If aid were to be united completely those credits could be put to better use, for the LDC's could then buy what they need for development, machinery for example, at the best available price. Their terms of trade would thus automatically improve. Whether untying aid would add greatly to the resources available to the LDC's is difficult to estimate. Psychologically, however, it should give the LDC's a considerable lift.

But while the United States has expressed itself as prepared to untie aid in concert with other nations, no such action has taken place, as has also been noted above. Furthermore it seems unlikely that either the President or Congress would approve of untying U.S. aid unilaterally. However, with the Common Market enlarged by the addition of Britain, Denmark, and Ireland, this may be an appropriate time for the United States to press the other OECD countries to join in a general untying of aid. Logically the untying of aid is part of the process of liberalizing trade, but it is also separable from that liberalization in a strictly legal or pragmatic sense. It may also prove more acceptable domestically than the extension of preferential treatment to the manufactures of the LDC's, but that remains to be seen.

6. The United States may, of course, exercise the option to implement its commitment to such preferential tariffs for the LDC's. The way would be clear as far as GATT is concerned, which as we have seen, has already given a general waiver to develop countries to extend preferential treatment to the LDC's. Whether the establishment of preferential tariffs favoring the LDC's by the United States would result in a great leap upward in their export earnings is perhaps debatable, but again, such a move could initially bolster the confidence of the developing states. If the export earnings of the LDC's proved to increase significantly, then such a move by the U.S. could have long run significance.

a. However, there would very likely be substantial and maybe overriding opposition in Congress to this country's establishment of preferences for the LDC's. The basis for this opposition lies in the fact that economic conditions, while improving, may not be conducive at this time to actions that could be interpreted as making concessions to foreign government and workers at the expense of the American worker.

1. In addition, there are indications that Congress is unhappy, on constitutional grounds, with the executive's commitment to preferences. The Senate Finance Committee, in a survey of current issues to be studied by its Subcommittee on International Trade, reported that "Even though the Executive has recognized that tariff prefer-

ences require legislation, it is questionable logic to 'commit' the United States to a particular plan without prior congressional review and authorization." [68] Indeed, many members might use stronger language, and consider such a commitment by the Executive to be a usurpation of Congress' authority in the field of interstate and foreign commerce. The Subcommittee also criticized U.S. agreement to generalized tariff preferences when, as we have seen, Western Europe and Japan agreed to the potentially far more restrictive tariff-quota preference system.[69] It asks the important question as to what will happen to U.S. relation with the LDC's whose hopes and expectations have been built up by the Executive if Congress rejects or substantially alters the preference plan, upon which it was not consulted, in a way that damages the export prospects of those countries.

D. INTERNATIONAL IMPLICATIONS OF A LIBERALIZED TRADE POLICY TOWARD THE LDC'S

1. In asking about the effects of a possible Congressional rejection of executive plans for tariff preferences, the Finance Committee put its finger on an important issue, namely, the impact on U.S. relations with both the developed and underdeveloped world of any decision to implement a preferential tariff system.

It seems safe to say that the establishment of preferences ought to improve the standing of the United States with the developing countries as a group, both those who would hope to sell their goods here under a liberalized trading set up, and those with little if anything to sell. The former may see such an establishment as constituting a direct boost for their development, while the latter may simply be pleased that a desired form of development aid has been made available to those of their fellows who are able to utilize it. On the other hand, since the manufactured goods of the LDC's are often both similar and competitive, the installation of preferences might be the occasion for increased tension among LDC's seeking to sell in the American market, for which the United States might be blamed.

2. Those developed countries which have already put a form of preferential treatment for the LDC's into practice ought to welcome similar action on the part of this country. Only when their exports to the United States are unfavorably affected by preferential treatment accorded the LDC's should the developed countries final reason to complain.

3. The crux of the preference issue, in policy terms, is essentially domestic. It lies in the effect of preferential treatment for LDC-produced goods on the domestic markets of U.S. industry. If the impact proves to be negligible, it stands to reason that little opposition ought to be aroused, or if aroused initially, it should diminish in strength. On the other hand, if the impact of such goods proves to be considerable, and Americans lose jobs as a result, a policy of preferences could backfire. In that event not only would resentment be aroused against the particular LDC's whose products were hurting domestic industry the

[68] U.S. Congress. Senate. Committee on Finance. Foreign Trade. A survey of current issues to be studied by the subcommittee on international trade. Committee Print (92d Cong., 1st session), U.S. Government Printing Office, Washington, May 14, 1971, p. 16.

[69] See pp. 56–58 *supra*.

most, but this resentment could well be extended to encompass development aid programs of all types.

Such an erosion of support for development assistance might be acceptable to its supporters if liberalized trade were genuinely viewed as the complete alternative to aid. However, nowhere in the sources examined for this report are the alternatives posed in this fashion. Trade policy is uniformly viewed as complementary to aid, not as a substitute for it. Therefore, from the standpoint of supporters of development aid, preference ought to be applied with care and caution, so as not to cause the kind of disruption to the U.S. economy which would produce a reaction against all forms of aid.

V. The Investment Alternative

One course of action that has been advocated by a number of people as an alternative to official bilateral development assistance is increased private investment. Hopefully the amount of private investment would expand as the amount of government-to-government aid declined, and if ideal conditions prevailed the former could completely replace the latter. It is theoretically possible, although highly unlikely, that private investment could exceed the amount of development assistance that had been forthcoming from the U.S. Government on a bilateral basis. Even if this state were to be attained, however, there are questions about extensive use of foreign investment as an instrument of development. The first of these is whether it ought to be considered as assistance at all.

The position to which the United States and other developed countries adhere is that private foreign investment should be considered as development aid. The justification for that view is put by Willard Thorp as follows:

> There are those who argue that only official flows should be included in any statistical estimate of "foreign aid" as did the Latin American countries at Vina del Mar when they asked for agreement "that private foreign investment should not be considered as aid or calculated as part of financial cooperation for development purposes." Regardless of how it is classified, there can be no question that private flows make a substantial contribution to economic development. To be sure, the greater part of this flow represents foreign investment inspired by the prospect of profit. But the less-developed countries also profit from it.[70]

Thorp goes on to point out that an outside investment, by developing an oil or mineral deposit, can actually expand the tax base available to an LDC. Foreign private capital increases industry and trade, hence employment and national productivity, besides acting as a demonstration center for modern managerial and technological methods. Foreign companies frequently train domestic personnel, they open up opportunities for the investment of local capital, and they make secondary contributions to development in the form of hospitals, vocational training, housing, and cross-cultural contacts.

The opposing point of view is put by Michael Lipton of Sussex University, England. He writes:

> Private investment by rich countries in poor ones has fluctuated wildly around an uptrend, but it is absurd—if convenient to such reluctant donors as the U.K.—to add this to aid and form an overall target. For a start, inflows of private investment—while net of disinvestment—are estimated *without* netting out profit repatriation, known to be far more than new inflow for India, Latin America, and probably poor countries as a whole. Secondly, neither governments nor UNCTAD can control national or total, gross (or net) flows of private foreign investment, let alone their allocation to or within countries. Thirdly investment, while often desirable, has no gift element. For all three reasons the inclusion of private foreign investment with aid in a composite target—as if it were all

[70] Thorp, Willard, *The Reality of Foreign Aid*, *op. cit.*, p. 177.

homogeneously controllable, comparable giftwise, and clear of reverse flows—is what the Germans call, usefully but untranslatably, "irrefuhrend." [71]

Mr. Lipton's view appears to coincide with that of many developing countries, while those of Mr. Thorp, as we have seen, parallel the views held by the developed states. The same set of facts, in other words, is looked at from differing perspectives.

This study does not attempt to make a brief as to whether or not private overseas investment can appropriately be included in totals of developmental assistance. It seems important, however, to be aware of the view which holds that investments should be differentiated from aid, and of the strength with which that view is held by many in leadership positions in the developing countries.

A. THE VOLUME OF U.S. INVESTMENT IN THE LDC'S

The volume of American private investment in the developing countries has amounted to about half the volume of such investment in developed areas of the world. This is illustrated by the attached table, Figure 2. The reason why investors have allocated their funds in this fashion is basically simple. There is greater stability in the developed countries, which means that investments are safer and earnings are surer.

An analysis of Figure 2 shows that the Latin American republics receive by far the largest share of private U.S. capital of the various underdeveloped areas. According to the DAC 1971 Review of Development Assistance, significant increases were registered in the Cabribbean area, and in Spain, with substantial increases attributable to petroleum investment in Venezuela, and manufacturing investments in Argentina and Mexico.[72] Investments in Asia and Africa remained in 1970 pretty much where they had been in 1969.

The Department of Commerce, in a report covering plant and equipment outlays of foreign affiliates of U.S. corporations, noted that these outlays have gradually shifted toward the less developed countries from a prior emphasis on Canada and Western Europe. Latin American countries have been the prime beneficiaries of this shift in recent years, reflecting increased investment in extractive industries. For the less developed areas as a whole, however, investment by foreign affiliates of U.S. corporations went first to petroleum, and second to manufacturing. New direct investment, which Thorp labels "probably the most significant . . . for development purposes," [73] because management and technical assistance usually accompany the capital, has gone more heavily to Latin America, the less-developed countries of Europe, and the petroleum producers, than to the remainder of the underdeveloped world.

This tendency toward concentration of private investment in petroleum can be strikingly illustrated in the case of Africa, basically a poor cousin insofar as U.S. private investment is concerned, but where that investment has been growing rapidly of late. Seventy-five percent of U.S. private investment in Africa is now situated in the developing

[71] Lipton, Michael, U.N.C.T.A.D.-Schmunctad? The Round Table. No. 247, July 1972, p. 304. Italics included.

[72] Organization for Economic Cooperation and Development. (OECD). Development Assistance Committee (DAC) 1971 Review of Development Assistance, p. 87.

[73] *The Reality of Foreign Aid*, *op. cit.*, p. 181.

countries, while the remaining 25 percent is to be found in South Africa. But of the investments in developing Africa, 73 percent are in petroleum, particularly in Libya and Nigeria, 13 percent in mining, and only 3 percent in manufacturing.[74]

The fact that the geographical and industrial distribution of U.S. private overseas investment may not be ideal from a development standpoint highlights the basic difficulty in the reliance on private investment to take up any slack caused by the reduction, suspension, or termination of bilateral aid. For private investment decisions, as we have seen, are based on the criteria of safety and profitability. Thus, funds may not go where they are needed most, or where they will do the most good in terms of development. A developing country can, presumably, regulate investment within its borders so that it flows into channels which coincide with that country's development priorities. In so doing, however, an LDC risks driving away private foreign capital which may feel its prospects threatened or its opportunities constricted by such regulation. But a developed country, if it attempts to prescribe the countries or areas in which its nationals may invest, or if it stipulates the mode of that investment, may find that it is compromising the essentially private nature of such investments. This could be the case whether the government in question was acting to foster the interests of the LDC's or whether it was acting in pursuance of its own economic or political objectives.

B. U.S. POLICY TOWARD PRIVATE OVERSEAS INVESTMENT

U.S. policy aims at promoting private investment in the third world by reducing the risk to the investor. A number of programs have been set up to serve this aim. First, the convertibility of earnings derived from U.S. investments in the countries covered by the European Recovery Program, or from the sale or other disposition of these investments, was guaranted in 1948. Since that time guaranties have been broadened until they now cover losses due to expropriation or confiscation, war, revolution, and insurrection. There are also guaranties against losses on loans made for housing mortgages in Latin America, losses on loans for credit unions, and for seventy-five (75) percent of the losses arising out of such other risks as the President may determine. The guarantees against inconvertibility, expropriation, confiscation, war, revolution and insurrection constitute what is known as the specific risk guaranty program, while the guarantees against insurable risks designated by the President is known as the extended risk guaranty program. Virtually all types of risks are now covered, except fraud on loan investments and fraud and misconduct on equity investments. All insurance or guarantees are operable only where the government of the developing country concurs.

The administration of these various program has been consolidated in the Overseas Private Investment Corporation (OPIC), which was created by Congress in December, 1969. OPIC also administers a pre-investment assistance program. Those insured by OPIC pay a fee for its services, and the income thus earned takes care of OPIC's administrative expenses. OPIC also maintains a small revolving capital

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[74] U.S. Department of State. Bureau of Public Affairs. Department of State Publication 8663. African Series 52. Washington. 1972, p. 6.

fund, called the Direct Investment Fund, from which it makes direct commitments of its own capital.

Llyod's of London shares in OPIC's expropriation risk program, except for Chile.

In addition to the insurance program, there are other inducements provided by the U.S. Government for the would-be overseas investor. Both AID and the Department of Commerce provide him with a variety of informational services. Tax advantages are also granted, as in the case of foreign subsidiaries of U.S. corporations, where the parent company pays no U.S. tax on the subsidiary's earnings until they are remitted to this country. Finally there is the so-called "Cooley loan" program under P.L. 480, where local currency generated by the sale of agricultural commodities can be loaned to U.S. private investors and to foreign companies to facilitate the distribution, utilization, and commerce in such commodities.

There is, of course, some criticism of these various programs as devices to aid U.S. lenders and exporters at the expense of the American taxpayer. The rejoinder to that argument often maintains that to the extent these incentives elicit additional investment in the LDC's, the need for direct government-to-government aid is reduced, and with it the burden on the taxpayer.

C. THE AMBIVALENCE OF DEVELOPING COUNTRIES

While leaders of developing countries usually take the public position that they welcome private investment as an instrument of development, their private feelings are often quite ambivalent. This ambivalence faithfully mirrors the views of the leadership classes of those countries, and to a lesser extent of the population as a whole. Obviously the leaders and the people of the developing countries want the jobs and the opportunities for economic growth that investment by outsiders can create. By the same token they are very much concerned lest such foreign interests gain control of their economies. Much of this can be attributed to the colonial past of so many of the developing countries, when their resources were exploited for the benefit of the metropolitan power. Some of it may be attributable to the Marxist-influenced views of many leaders of the LDC's, for whom foreign investment constitutes imperialistic economic penetration. Dogma aside, however, the fear of the LDC's that foreign investment means that outside interests over which they have no control can make decisions vitally affecting their economies is certainly not unreasonable, and has ample warrant in historical experience.

2. Whether sympathetic to Marxist interpretations of history or not, a great many developing countries prefer state planning of the economy over private enterprise. They believe that a relatively tight state control of the economy is a prerequisite to development, and hence prefer government-to-government aid on a bilateral basis, or assistance from multilateral organizations. Such external private investment as is admitted is subject to strict controls. Sometimes these controls may be instituted as a result of pressure by the local business community, which ranges from the rudimentary in some countries to the quite sophisticated in some others, and which in neither case is eager for foreign competition.

3. Given the ambivalence toward foreign investment on the part of the LDC's, it is logical that they should display a certain wariness toward American corporations seeking to invest within their boundaries. Certainly the American corporation already on the ground, particularly in the extractive or communications industries, presents a high visibility target. Threats of expropriation and outright takeovers have occurred. There was the famous Mexican nationalization of American oil properties in 1938, while among the more recent seizures have been the nationalization of U.S. oil properties in Peru in 1968, and the takeover of the telephone system owned by the International Telephone and Telegraph Company (ITT) in the state of Rio Grande de Sul, Brazil, in 1962. The Brazilian expropriation was cited by proponents of the Hickenlooper amendment, which Congress passed in 1962, and which required a cut off in U.S. assistance to any country expropriating U.S.-owned property without offering appropriate compensation within six months time. In point of fact the government has been quite reluctant to apply the amendment, and it was invoked only in the case of Ceylon's nationalization of foreign-owned oil properties in 1963. (Even then, not all U.S. aid to Ceylon was suspended.)

4. Despite their objections to outside private investment, there is substantial recognition by the governments of the LDC's that the capital needed for their development has to come, in part at any rate, from private sources. Indeed the development program in some countries depends heavily on private investment. Thus a number of LDC's have taken action designed to attract that investment.

a. One fairly common device for this purpose is a guarantee by the LDC that outside private investors will be able to repatriate both capital and profits, although such repatriation is often made subject to exchange controls.

b. Another type of inducement consists of an adjustment in tariff laws to permit foreign investors to import plant and equipment for manufacturing, and sometimes raw materials and components necessary for manufacturing as well.

c. Tax concessions may be included, either separately or as part of a comprehensive package. Assurances against expropriation, or promises of just compensation in the event of nationalization may also be included, although the latter provision is hardly likely to be reassuring to the would-be investor. Some LDC's have entered into investment guarantee agreements with the United States which permit U.S. firms operating within their territory to be insured by the U.S. government against inconvertibility, losses due to expropriation, and losses due to war or insurrection. (Only a few countries will permit the inclusion of this latter provision in any insurance agreement.)

d. Although desirous of receiving outside private help, many developing countries seek to utilize such assistance in order to sharpen the skills of indigenous personnel. Thus private investors may find that they are urged to participate in joint ventures with local businessmen as a condition of investment.

e. As an example of the kind of policy adopted by some LDC's to attract foreign capital there is the instance of Iran. Iran offers duty free entry for machinery and supplies, a fifty (50) percent exemption from taxes on net profits for foreign investors, a five year tax holiday for productive enterprise established at least 60 kilometers away from Teheran, and a five year income tax exemption for producers of goods manufactured for export.[75]

D. PRIVATE INVESTMENT AS AN ALTERNATIVE TO BILATERAL AID: AN EVALUATION

1. It should be apparent from the discussion in the section immediately preceding (section C), that outside private investment in the developing countries is going to encounter a wide range of responses. In some instances it will be readily accepted, in others the acceptance will be grudging. Certainly the harassment of foreign investment is not unknown, and the specter of potential expropriation can seldom be completely obliterated.

What this means, from a policy standpoint, is that private foreign investment is at least as vulnerable to political attack within the host country as bilateral aid, and in some cases even more so. Thus whatever advantage it may possess as an alternative to bilateral aid, political invulnerability is not one of them. Furthermore, since private investment is sometimes lopsided, being heavily concentrated in extractive industries, it can be criticized as being more in the interest of the investors than the developing country. Any investment that threatens the removal of local natural resources is often a natural target for attack.

2. If bilateral aid is phased out at some future time, it is difficult to envision that private investment will increase sufficiently to make up the gap. Total bilateral assistance extended by the U.S. government in fiscal 1971, for example amounted to $4.8 billion, including assistance under the Foreign Assistance Act, PL 480, Export-Import Bank loans, and other economic aid programs. By way of comparison, the flow of net direct investment from the United States to developing countries in 1970 amounted to $1.6 billion.[76] Although these two time periods may not precisely overlap they do cover roughly the same period, during which time U.S. bilateral development aid amounted to three times as much as U.S. private investment. While it is possible that private investment in the LDC's can increase markedly in the years ahead, it may be too much to expect that it will eventually be able to supplant bilateral aid altogether. If private investment cannot provide the same volume of resources for development assistance as can be made available via bilateral aid programs, it may not serve the national interest or the interest of the developing countries as well as present arrangements.

3. As with trade, the requirements of the developing countries appear to necessitate a combination of private investment with bilateral aid. There also appears to be a need for additional research into methods of stimulating a greater flow of private investment into the LDC's, assuming the government to be genuinely interested in that objective. In the same fashion there needs to be an ongoing concern with the most efficient use of U.S. private resources by the developing countries. One

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[75] Thorp, Willard. *The Reality of Foreign Aid. Op. cit.* p. 187.
[76] OECD 1971 Review of Development Assistance. *Op. cit.* p. 87.

method that has been suggested, for example, would link the entreprenurial skills of private U.S. citizens with the public resources of the LDC's. In any event, all agencies interested in the problem of international development might be consulted on this question of developing new techniques for fostering private capital flows, with the prime responsibility concentrated in AID, the State Department, the Treasury Department and the Export-Import Bank.

VI. Development Aid Reconsidered

A. WHAT ENDS DOES THE UNITED STATES SEEK?

Before choosing among the alternatives to the present bilateral foreign aid program which this paper has discussed, the government and people of the United States need to make another choice, a choice of aim. For the ends they wish aid to serve will determine, to a large degree, the nature of the program which is finally adopted. This question of aims is not new, but this seems an appropriate time to raise it once again. Once a program or combination of programs is decided upon, the next question is how it may be operated most efficiently. The answers to both these questions, moreover, are governed by the political and economic situation in the developing countries, in the other developed countries, and here in the United States.

1. Among the aims which have been ascribed to foreign economic aid and from which a future choice of emphasis may be made, are the following:

a. Economic development *per se:* With this as a primary aim, economic development is considered good in itself, and may be related only marginally to U.S. foreign policy goals. (By way of contrast, the Marshall Plan was related to a very specific goal of U.S. policy.) A key drawback of this aim, from the standpoint of aid supporters, is that it is unlikely to add appreciably, if at all, to the total of those supporters. It is difficult for the American people to see, for example, how they benefit if the GNP of some underdeveloped country is raised by one percentage point.

b. To improve the lot of poor people the world over: This moral aim of foreign aid is unchallengeable on its face, and constitutes a prime source of strength for the foreign aid principle, and for a number of specific programs, by many organizations and private individuals. Yet, as Huntington points out, the moral argument is persuasive when it comes to providing minimum economic well being for individuals, but much less so with respect to promoting economic growth. We justify development aid on the basis of economic performance, not need, and we look for self-help from the recipient of this economic assistance.[77] On the other hand, it is certainly moral to take the approach that assisting the LDC's to develop more rapidly will be more effective, and will have a greater long term effect, than simply helping needy groups or individuals.

c. To promote U.S. economic interests: The United States could furnish development aid to the LDC's purely for the purpose of promoting the sales of its products abroad and of exploiting new outlets for investment. Presumably the LDC's would have to come a long

[77] Huntington, Samuel P., Foreign Aid for What and For Whom. *Foreign Policy*, Winter 1970–71, pp. 175, 176.

way before offering markets and outlets as attractive as those presently found in other developed countries. Nor could the United States be particularly frank about such an aim, especially in view of the suspicion of U.S. motives voiced by many in the developing countries. Indeed it may well be counter-productive politically for the United States to advance assistance to developing countries with its own economic interests primarily in mind.

d. To enhance U.S. influence in the developing countries, for now and for the future: This has often been advanced as a goal of U.S. development assistance. It is asserted that the non-Communist developing countries contain an even larger share of the world's population than China, that they are our major suppliers of oil, copper, tin, timber, vegetable oils, rice, rubber, jute, sugar, coffee, tea, cocoa, cotton and textiles, and that their share of world trade exceeds that of European and Asian Communist countries combined.[78] Even though the LDC's lack the substance of real power now, not all of them are powerless, and several of them are potential great powers. Their very numbers give them power in international bodies such as the UN United States that the LDC's so frequently vote against her. While the General Assembly, where it is a source of embarrassment for the United States cannot expect to win the LDC's completely to her point of view, development assistance is a source of leverage for the present and an investment for the future.

Opposed to this argument is the familiar proposition that you can't buy friends. Votes against the United States in the United Nations by beneficiaries of U.S. aid, such as the vote to expel Taiwan, are cited as evidence of this contention. It is further asserted that the likely outcome of the giver-receiver relationship insofar as aid is concerned is resentment, ill-will, and frustration on both sides. Thus it is mistaken to expect any positive political influence as a result of development assistance, in this view. Furthermore, the argument goes on, economic development is not always given the priority by the developing countries that people in the developed countries assume they assign to it. Indeed those holding this view maintain that the United States itself has higher priorities in some of the poor countries than their economic development—preserving the territorial integrity of India, let us say, being a more important consideration than her economic advance.

Those who question the value of a political aim for foreign aid could probably accept the proposition that U.S. relations with both developed and underdeveloped states are impaired by failure to provide development assistance in amounts those countries deem sufficient. When the United States does not meet internationally-assigned targets, or is less than enthusiastic about increasing its development assistance, critical opinion abroad is quick to express itself, and the greater the dissappointed expectations the shriller the criticism. Thus what Huntington calls a "derived or secondary political interest"[79] might serve as an acceptable aim for those who otherwise question the validity of aid as a political instrument.

e. To strengthen U.S. security: It is frequently asserted that the gap between the rich nations and the poor nations is growing, and that

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[78] Clark, Paul G., *American Aid for Development*, N.Y. Praeger, 1972, p. 72.
[79] Huntington, Samuel P., Foreign Aid for What and for Whom, *Foreign Policy, op. cit.*, p. 178.

there must be a reduction in this gap lest the misery of the world's poor explode in violence. Presumably this violence would be directed at the world's affluent nations, including the United States, and hence the rationale that aid made a contribution to U.S. security.

It is not difficult to point out flaws in this argument, for the poor countries are hardly in a position to attack the developed countries, however wronged and frustrated the former may feel. But to dismiss the security argument in this fashion may be too easy. For the insta bility and upheavals that have marked the internal and external affairs of the LDC's have had their repercussions among the developed countries, and sometimes those repercussions posed the danger of a confrontation between the West and the Communist powers—and specifically between the United States and the Soviet Union. Certainly the Arab-Israeli wars, the India-Pakistan wars, the "confrontation" between Malaysia and Indonesia pursued by Sukarno, the Nigerian-Biafran civil war, all comprised threats to international peace and security of varying intensity. Until quite recently it was widely assumed that the Vietnam war carried a serious danger of nuclear confrontation between the United States and either China, the U.S.S.R. or both.

In short, to say that aid strengthens national security seems to be realistic if one means that aid can help reduce the turmoil in the third world, particularly the danger of wars between the LDC's which might escalate and involve the United States. Any aid program that genuinely contributes to this end can be described as rendering a positive service to U.S. national interests.

f. To strengthen international order: This is an objective formulated by Paul G. Clark, and he sees the U.S. development assistance program contributing to this end in four ways. First, it can strengthen the position of governments which are comparatively open and cooperative in world affairs. Second, and this point is similar to above, aid in support of rapid economic development can help reduce the risk of revolutionary disorder and violence. However, aid by itself cannot assure nonviolent evolutionary change, given the tensions of modernization and the weakness of many governments. Third, and this is also related to the above, by making it easier for LDC's to emphasize development, U.S. aid can do something to moderate the risk that outstanding grievances between LDC's will lead to overt military action. Again, Clark admits that aid cannot realistically be expected to prevent all wars between low income countries, but he argues that the fact that India and Pakistan lived with their antagonism over Kashmir for almost two decades, and that after a military campaign the issue "was fairly quickly submerged again," is evidence of the competing appeal of national development efforts in both countries. Finally, since development assistance involves collaboration of low-income and high-income countries, it can be an important force in gradually strengthening international order. Under bilateral programs there has to be a reasonable amount of openness and cooperation between giver and receiver, and under multilateral programs there must be broad cooperation for common purposes.[80] This last point of Clark's

[80] Clark, Paul G., *American Aid for Development*, op. cit. pp. 75–76.

appears to embody a worthwhile aim for aid, and perhaps should stand by itself, rather than as part of a broader objective. On the other hand, many would maintain that collaboration between developed and less developed countries is a happy by-product of development assistance programs, but that such programs should not be launched simply to develop habits of international cooperation when there is ample scope for the development of such habits in a variety of international activities.

g. To reduce poverty and foster social reform and political development in the developing countries: One argument that is frequently advanced against existing developing assistance programs is that they are marked by a common failure to deal successfully with the problem of poverty. The standard approach to development has been to emphasize increases in gross national product, or per capita income, or both. But this approach in and of itself does not come to grips with the problem of poverty in the LDC's. This is borne out by the fact that official and unofficial assistance can pour into the LDC's in amounts sufficient for growth targets to be achieved, yet no appreciable change may occur in the quality of life for the vast masses living in abject poverty.

The degrading character of this poverty is exacerbated by the inequities in income distribution, inequities whose mitigation or abolition is primarily the responsibility of the developing countries themselves. However it is not their responsibility alone, for the aid-giving countries can hardly permit their assistance to perpetuate indefinitely a situation where "the rich get richer and the poor get poorer." To do so would be nullify the very purpose for which development aid was undertaken, and would be utterly self-defeating. Thus, the argument runs, if the developed countries wish their aid programs to achieve meaningful results, they must address the interlocking problems of poverty and the maldistribution of wealth in the underdeveloped nations. They must also assist the people of the developing countries in utilizing their political potential to help bring about a greater measure of social and economic justice. Robert S. McNamara, President of the World Bank, put it this way:

> * * * We should stop thinking of massive poverty in a developing country as simply a symptom of underdevelopment—and begin, rather, to think of it as a condition that must be attacked within the framework of the Nation's overall development program.[81]

If the developed countries design their assistance programs to heed this advice, they may at times find that they have to prod the developing countries toward reform, perhaps to the extent of conditioning aid on the adoption of needed changes. Naturally such pressures will be resented by the LDC's, and relations between the aid-givers and the aid-receivers may deteriorate. However, such resentment and deterioration may be held to a minimum if the LDC's are convinced that the developed countries are genuinely interested in helping them cope with the whole broad range of developmental problems. This is a sector where presumably disinterested multilateral programs would seem to possess an inherent advantage.

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[81] Address to the United Nations Conference on Trade and Development. (UNCTAD III). Quoted in Congressional Record. Apr. 27, 1972, P.S. 6841.

A number of measures have been urged upon third world countries to assure the more equitable distribution of the fruits of economic growth. These include effective land reform, programs to increase the productivity of the small farmer, policies which would secure tenants in their holdings, fair and comprehensive taxation, and educational reform. To assure continued growth itself as well as greater equity in the distribution of income, measures to check population growth and to create additional jobs have been widely advocated.

B. AID AND U.S. FOREIGN POLICY IN THE POST-VIETNAM ERA

Proposed alternatives to the present bilateral aid program must be assessed against the backdrop of a U.S. foreign policy that is in a state of flux. The premises of the 1950's and 1960's have not been completely overturned, but they exist side-by-side with what might be called post-Vietnam (in the sense of post-U.S. entry into the Vietnam conflict) assumptions. Thus it is possible for the President to say, for example, that the postwar era has ended, and in the same report to state that the Soviet Union's ideology dictates an attitude of constant pressure towards the outside world.[82] Thus it is possible at one and the same time for the United States to sign a Strategic Arms Limitation Treaty and for the Secretary of Defense to propose an increased defense budget. There is a recognition that the monolithic character of Communism has ended, that new power centers are emerging in the world, that nationalism is perhaps the most powerful dynamic presently affecting the relations of nations, and that trade and other economic factors (including development) may well play a greater role in international politics than they have heretofore. These attitudes exist alongside anxieties over seemingly contradictory or tension building trends, such as Soviet naval expansion in the Mediterranean. It is also recognized that certain issues—preservation of the environment for example—transcend geographic and ideological boundaries, and can only be solved by international cooperation that bridges the old barriers between East and West.

In these circumstances the President has elaborated the "Nixon doctrine," which essentially calls for a lowered U.S. profile overseas. Foreign aid is to be continued, but there are to be larger applications of self help by the receiving nations, while the developed countries, it is hoped, will contribute more. Many who subscribe to the view that the United States should cut back its military commitments abroad would also reduce our economic assistance, or channel the bulk of it through multilateral organizations.

C. AID AS A COMPREHENSIVE PROGRAM

This study was undertaken on the assumption of a serious Congressional interest in maintaining U.S. participation in the development process, free of the shortcomings that have so frequently been ascribed to bilateral assistance. Advantages and disadvantages of the various alternatives to direct bilateral assistance were set forth with that

[82] U.S. Congress. House. Message from the President of the United States transmitting his record annual review of the United States Foreign Policy for the 1970's: Building for Peace. House Document 92-53. Washington. Feb. 25, 1971, pp. 1, 124.

assumption in mind. The developing countries are prone to feel that not enough assistance is made available to them and many professed partisans of development assistance in this country feel essentially the same way. Robert R. Nathan, in testimony before the Subcommittee on National Security Policy and Scientific Development of the House Foreign Affairs Committee, when asked about alternatives to the bilateral programs that constitute the backbone of foreign aid, responded as follows:

* * * There just is no magic key to economic development which deals with human beings, deals with leadership, deals with initiative, deals with incentives, deals with organizations, deals with policies and actions. This is inevitably complex and multiple in its characteristics and solutions. * * * What worries me is not that we should not try all these, because I think we must try all of them, Mr. Chairman, but what worries me is that we may forego what we ought to do ourselves in our own interest and in the interest of peace and progress in the world, while seemingly favoring one effort at the expense of another and end up cutting down on both. We may do just that in shifting emphasis from bilateral to multilateral channels.

I have said many times in the past that I am terribly distressed at the possibility of our cutting down on bilateral aid and then we beat the devil out of the multilateral agencies. This is a danger. What I think we need to do, Mr. Chairman, is to work on all these and other approaches as well.[83]

Testifying at the same time, President of the Overseas Development Council, James P. Grant, agreed with Mr. Nathan, yet he stressed the importance of trade, and the concomitant necessity of helping some of those who lose their jobs because of imports.

As far as the United States is concerned the concept of national interest, which must be considered a main justification for development assistance, is sufficiently flexible to permit the simultaneous existence of different categories of aid programs. There appears to be no overriding reason, in short, why the encouragement of private investment, the lengthening of loan repayment periods, increased multilateral assistance, or trade preferences for the LDC's cannot exist side-by-side with the core of bilateral assistance as it is presently known.

The flexibility afforded by the concept of national interest also extends to the question of the allocation of development assistance, both as to time and as to place. While the LDC's have a great deal in common, there are also significant points of difference. Comparable countries may require different types of aid programs, or one may need assistance while the other has progressed to the point where outside aid is unnecessary. The national interest concept also serves as a broad umbrella covering narrower objectives of foreign aid, such as the economic, political, or security arguments. Finally, it is a generally applicable criterion against which requests for development assistance can be measured. It may be to the U.S. interest, for example, to transfer resources to a particular developing country because that country not only needs them, but can put them to effective use. In another instance our domestic needs may take priority, in terms of the national interest, over the transfer of other resources. In a third instance liberalized trade or increased external investment might be preferable, in terms of the national interest, to a direct transfer or resources.

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[83] U.S. Congress. House. National Security Policy and the Changing World Power Alignment. Hearing-Symposium. Committee on Foreign Affairs. Subcommittee on National Security Policy and Scientific Developments. 92d Cong., 2d sess., Washington. USGPO. 1972, pp. 248-49.

All of this seems to imply that there is room, under the general heading of development assistance, for a broad variety of options, permutations and combinations. A certain core or residue of bilateral aid is necessary if only to permit the United States to employ aid for objectives which this country deems to be in its interests, but which might be vetoed by other donors under multilateral arrangements. Multilateral programs obviously have their place, though, particularly in exerting pressure for economic and social reform in the LDC's. In so doing they can be more effective than the U.S. individually, since the same suspicion does not attach to United Nations or regional pressures for reform as would be manifest if such pressure emanated directly from the United States. The adoption of a preferential system, the lengthening of repayment periods and the reduction of interest rates, and the expansion of private investment in the LDC's, can mean a reduction in the amount of bilateral assistance previously thought essential for a meaningful aid program.

For the foreseeable future it appears that the U.S. development assistance program will be eclectic. There will be bilateral and multilateral assistance programs, with the latter perhaps increased significantly in amount and the former reduced either partially or commensurately. The encouragement of foreign investment seems likely to continue, whether the guarantee and insurance programs retain their present form or not. Movement on the issue of tariff preferences and debt refinancing is harder to predict, but it should not be too surprising if Congress passes legislation relating to these matters.

For the aid program to be what many would consider its most effective, Congress would merely draw or re-draw the broad guidelines of policy, allowing the executive agencies to apply these guidelines in individual cases. Congress could see to it, however, that specific aid programs be altered where necessary to incorporate the latest thinking on development, such as the necessity of creating jobs in the LDC's. An aid program which combined the best of the various approaches to development assistance might do much to win back much of the support that development aid once commanded.

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