Development Issues

First Annual Report of The President on U.S. Actions Affecting the Development of Low-Income Countries

Transmitted to The Congress May, 1975

Prepared under the Supervision of the Development Coordination Committee

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DEPARTMENT OF STATE
DEPARTMENT OF TREASURY

THE DEVELOPMENT COORDINATION COMMITTEE
WASHINGTON, D.C. 20523

May 6, 1975

THE PRESIDENT:

Sir: On behalf of the Development Coordination Committee, I am pleased to submit the first annual report on Development Coordination.

Respectfully,

Daniel Parker

Daniel Parker
Chairman

The First Annual Report of the President On United States Actions Affecting the Development Of Low-Income Countries

To The Congress of The United States:

I hereby transmit to the Congress the First Annual Report on Development Coordination, in accordance with Section 640B (d) of the Foreign Assistance Act of 1961, as amended.

This is an appropriate time for the first report on the policies and actions of the United States affecting the development of the low-income countries. Over the past decade, the economies of the developing countries have grown at an encouraging rate. This was partially because of American assistance. Consequently, many nations no longer need assistance on the concessional terms we once extended.

Unfortunately, there remain a number of very poor nations suffering from malnutrition and disease, poor educational opportunities, and very low incomes. Our policies must continue to reflect our belief that American well-being is intimately related to a secure and prosperous international environment and humanitarian and economic concerns that have for so long motivated our assistance programs. The increase in petroleum prices and the food crop shortfalls of the past several years—as well as world recession and inflation—have hit the poorest countries with particular severity.

In 1974, the United States worked with other industrialized nations and with various international agencies to adjust our assistance and trade policies toward the less-developed countries to meet the new situation and to ensure a coordinated and constructive response from the international community.

We have:

- adapted our bilateral development aid programs to give more assistance to the poor majority in the developing countries.
- supported multilateral institutions as a means for worldwide cooperation to promote economic and social development.
- responded to the world food problem by increasing food aid to the needy countries by increasing our assistance to help them grow more of their own food and by working with other nations to get a fully multinational response to food issues in accordance with the recent World Food Conference.
- signed into law a new Trade Act which will help enable poor countries to increase their trade with us, both by preferential treatment for their exports and by general lessening of barriers to world trade.

Much remains to be done. We must:

- work with high income countries to help meet the continuing needs of the poorest countries in the present world economic situation.
- continue our efforts to meet the long-run problems of food scarcities through a coordinated program of increased food production

in the poor countries, improved nutrition, increased food stocks and food aid, and research and development to boost food output everywhere.

- continue to provide opportunities for the developing countries to expand their trade with the United States and other industrialized nations.
- build on the results of the World Population Conference, fostering the maximum international cooperation in dealing with world population problems.
- find new techniques for working with those rapidly advancing countries that no longer require our concessional assistance, but are anxious to benefit from American skills and resources in their development programs.

The Development Coordination Committee was created to assist in ensuring that our policies and actions with respect to the developing countries are coordinated to reflect our interest in their welfare and improved quality of life, and to advise me on how our actions are affecting these poor countries and our own economy.

In recent years, there has been disillusionment with our ability to help others in this world. Our efforts have slackened. We have looked too much at our failures and not enough at our successes. While our economic problems at home are serious, we remain one of the most productive countries in the world. We have much to contribute and we have much to gain from economic cooperation with developing countries and from their economic progress. Our own prosperity will be enhanced if we remain true to our long tradition of assisting those in need.

If we help them to help themselves, we can work towards a stronger and more just international economy for the future, lessen human suffering, and increase our own security in a rapidly changing world.

GERALD R. FORD

THE WHITE HOUSE,
MAY 1975

Table of Contents

Page

List of Illustrations

Explanation of Abbreviations

ACP	African, Caribbean, Pacific Countries (associated with the European Community)
ADB	Asian Development Bank
AFDB	African Development Bank
AID	Agency for International Development
ASEAN	Association of South East Asian Nations
CARICOM	Caribbean Common Market
CARIFTA	Caribbean Free Trade Association
CCC	Commodity Credit Corporation
CERDS	Charter of Economic Rights and Duties of States
CIEP	Council on International Economic Policy
C-20	Committee of Twenty (of the IMF)
DAC	Development Assistance Committee of the OECD
DCC	Development Coordination Committee
EC	European Community
ECOSOC	Economic and Social Council of the United Nations
ECOWAS	Economic Community of West African States
EEC	European Economic Community
EX-IM	Export-Import Bank of the United States
FAO	United Nations Food and Agriculture Organization
GATT	General Agreement on Tariffs and Trade
GNP	Gross National Product
GSP	Generalized System of Preferences
IBA	International Bauxite Association
IBRD	International Bank for Reconstruction and Development, (The World Bank)
ICSID	International Center for the Settlement of Investment Disputes of the World Bank
IDA	International Development Association, the concessional loan window of the World Bank
IDB	Inter-American Development Bank
ILO	International Labor Organization
IMF	International Monetary Fund
IPPF	International Planned Parenthood Federation
ISC	Interagency Staff Committee (for food aid)

LAFTA	Latin American Free Trade Association
LDC	Less-developed country
MNC	Multinational Corporation
MSA	Most Seriously Affected Countries (by oil price increases)
MTN	Multilateral Trade Negotiations
NAC	National Advisory Council on International Monetary and Financial Policies
NIEO	New International Economic Order
NTBs	Non-Tariff Barriers
OAS	Organization of American States
ODA	Official Development Assistance (more than 25 percent grant equivalent)
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
POL	Petroleum, Oil, Lubricants
SDR	Special Drawing Rights
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
UNDP	United Nations Development Program
UNFPA	United Nations Fund for Population Activities
UNRWA	United Nations Relief and Work Agency for Palestine Refugees in the Near East
UPEB	Union of Banana Exporting Countries
USDA	U.S. Department of Agriculture

I

Introduction

Section 640B of the Foreign Assistance Act of 1961 as amended by Sect. 21 of the FAA of 1973 (PL 93-189:87 STAT 725) contains the following language with respect to the Development Coordination Committee (DCC):

Section 640B. COORDINATION.—(a) The President shall establish a system for coordination of United States policies and programs which affect United States interests in the development of low-income countries. To that end, the President shall establish a Development Coordination Committee which shall advise him with respect to coordination of United States policies and programs affecting the development of the developing countries, including programs of bilateral and multilateral development assistance. The Committee shall include the head of the agency primarily responsible for administering part I, Chairman, and representatives of the Department of State, Treasury, Commerce, Agriculture, and Labor, the Executive Office of the President, and other executive departments and agencies, as the President shall designate.

(b) The President shall prescribe appropriate procedures to assure coordination among—

(1) the various departments and agencies of the United States Government having representatives in diplomatic missions abroad; and

(2) representatives of the United States Government in each country, under the direction of the Chief of the United States Diplomatic Mission.

The President shall keep the Congress advised of his actions under this subsection.

(c) Programs authorized by this Act shall be undertaken with the foreign policy guidance of the Secretary of State.

(d) The President shall report to the Congress during the first quarter of each calendar year on United States actions affecting the development of the low-income countries and on the impact of those undertakings upon the national income, employment, wages, and working conditions in the United States.

The President, on February 28, 1975, signed an executive order establishing the DCC with the following regular membership, plus the option of including other agencies when the DCC is dealing with matters of interest to them:

Administrator of the Agency for International Development, Chairman
Under Secretary of State for Economic Affairs
Under Secretary of Treasury for Monetary Affairs
Under Secretary of Agriculture
Under Secretary of Commerce
Under Secretary of Labor
Special Representative for Trade Negotiations
President and Chairman of the Export-Import Bank of the United States
President of the Overseas Private Investment Corporation
Executive Director of the Council on International Economic Policy
Deputy Assistant to the President for National Security Affairs
Associate Director for National Security and International Affairs, Office of Management and Budget

The DCC was established as part of a general restructuring of the bilateral U.S. assistance program by Congress in the Foreign Assistance Act of 1973. The main thrust of that restructuring was to have the bilateral program carried out by AID concentrate on assistance in the fields of (a) food, nutrition, and rural development. (b) population planning and health, and (c) education. AID was also directed to seek to improve the lives of the poor majority of the low income nations and to reduce its emphasis on capital transfers, which can be carried out by multilateral assistance programs and other mechanisms.

The conception of the DCC in that restructuring grew out of a perception, both in the Congress where the initiative was taken and in the Executive Branch, that decisions with respect to United States policy towards the less-developed countries were being made in an unsystematic manner and that what was done in one area often was decided in ignorance of actions taken in other areas. Many illustrations of this could be cited: one part of the U.S. Government encourages food production or manufacturing abroad, while another seeks to limit the exports that would make this production viable; bilateral development assistance is handled in both the Executive and Legislative Branches by different agencies or committees, with the thrust of one often at cross purposes with the other; one part of the U.S. Government gives incentives to encourage U.S. private investment abroad, while another is concerned about foreign competition in the same field; one agency develops concern about the growing external debt problem of a particular less-developed country, while another makes loans exacerbating this problem.

Several other concerns led to the creation of the DCC:

—The U.S. has many policy instruments which affect its interest in the development of less-developed countries. Development assistance in the form of capital transfers or technical assistance is only one family of these instruments, and even this moves through various bilateral and multilateral channels with potentially differing impacts on U.S. interests. Trade and commodity policy, private investment policy, international monetary matters, technology transfers both from public and private sources, export credits, the ability to use our private capital markets, the treatment of debt of less-developed countries, food policy, techniques for affecting population growth, use of the seabeds—all are policy instruments which potentially affect development, some suited for some countries and others for other countries. The U.S. has not consistently orchestrated these instruments of policy, and a main function of the DCC is to seek to do so.

—The U.S. Government policy-making process, almost inevitably, concentrates on developed countries. When it does focus on less-developed countries, there is a tendency to highlight relatively short-term political considerations or partial perceptions of national security interests. The economic development aspects of our decisions frequently are examined superficially, if at all. All elements of policy—political, security, economic—are intertwined, and it is not always evident a *priori* which should dominate. The DCC was created in part to add another voice, to put some balance, into the decision-making process, so that the development aspects are considered alongside the other related considerations.

—Less-developed countries are becoming more important to our national self-interest. They are sources of raw materials and as they grow, they become better markets for our products. They contain the majority of the world's population, and perturbations in and among them are unlikely to leave us unscathed. The action of the oil-producing countries in raising prices has highlighted the interdependence of countries in a way that no rhetoric could. The efforts of countries producing bauxite, copper, bananas, coffee, iron ore, and, potentially, other products to improve their incomes from the export of their products has highlighted the impact on us of actions by others. Given our economic importance in the world, others always were aware of the impact on them of our actions.

The purpose of the DCC is to bring these strands together, and based on analysis and study, to influence the decision-making process from the viewpoint of the U.S. interest in the development process.

Since the DCC was not in operation in 1974, this initial annual report can not be an examination of its actions. Rather, it is a discussion of the effect of U.S. policies on less-developed countries. It examines the impact of our policies both on the development of other countries and on aspects of our own national economy. It refers also to substantive economic issues which deserve deeper analysis in 1975 and later to determine if present policies are likely in the future to best serve our national interests.

II

The Unity and Diversity of the Less-Developed Countries

Countries have a variety of national objectives, and the more complex the country, the more complex these are: for the less-developed countries, for the low-income countries, "development" is always an important objective. Development means different things to different countries and different observers. It can encompass growth in per capita income or gross national product, more equitable distribution of income, more education or perhaps more educational opportunity, lower infant mortality rates, better nutrition, or on a more elemental level in some countries, just more food. Other observers have tended to stress the importance of "participation" as a key aspect of development, i.e., not only should more people share in income growth, but they should share as well in the decision-making that takes place to define national and local objectives.

By now, since most countries that aspired to independence have become independent, domestic and international political rhetoric invariably emphasizes some aspect of development. It may or may not take priority internally over struggles for political power, but it usually is the key element in the propaganda that accompanies political struggles. Development may or may not always be the primary objective in the international policy of particular less-developed countries, but the language of international debate is increasingly the language of development. It has thus become impossible to understand what goes on in any country, or to understand a country's foreign policy aspirations, without understanding its development aspirations. Economic and social development has become the idiom of domestic and international politics.

The rhetoric of the less-developed countries takes place on different levels, and the emphasis may shift depending on the level in question. For example, in many international forums, particularly over the last decade, the rhetoric has been confrontational—that the rich countries are exploiting the poor, that the rules of the game must change, that a new international economic order is needed. Internally, less-developed countries often have followed different routes: in some, while the pronouncements of their international spokesmen are shrill, the cooperation between their international financial and economic managers and those from the "rich" countries is close. Some exploit their own poor while denouncing external exploitation; others have sought to bring about a greater measure of internal distributive justice.

The less-developed countries have tried to maintain a unified front in dealing with the developed countries. This unity was institutionalized at the first United Nations Conference on Trade and Development (UNCTAD), in 1964, when the Group of 77 (the number of less-developed countries now involved is larger) was born. It was manifest at the Special Session of the General Assembly of the United Nations in April 1974, which dealt with raw material issues, and must be expected when the next such Special Session convenes in the fall of 1975. It has been institutionalized as well in Latin America, where the Latin American countries seek to caucus as a group to present one position to the United States on any given issue.

What are the elements that pull the less-developed countries together?

—they have low per capita incomes relative to the rich countries;

—for the decade of the 1950's and part of the 1960's, when the habits of unity grew, the terms of trade (i.e., the relationship of the prices of the goods they export to those of the goods they import) of the less-developed countries as a whole were perceived by them as deteriorating in relation to the developed countries; more recently, the oil producers cited past low oil prices as an excuse to raise present prices, and to do this in such a way as to compensate for what they alleged was past exploitation;

—the end of colonialism and the growth of national identities have fostered this coherence;

—better communications and transportation, and the ability to meet together in multilateral forums, made unity possible;

—perhaps most importantly the less-developed countries have developed a conviction that the rich countries respond to repeated confrontation in a way they would not to importuning; some examples they cite are the creation of the International Development Association (the concessional loan window of the World Bank) and of the Inter-American and Asian Development Banks, the institution of the system of general preferences that grew out of the first UNCTAD, acceptance of the coffee agreement, and the admission of less-developed countries to the Committee of 20 which negotiated international monetary reforms rather than doing this in the Group of 10 which excluded them.

However, as soon as the less-developed countries are disaggregated, these elements of unity give way to characteristics and national interests that pull them apart. These include:

—different income levels, both nationally and per capita;

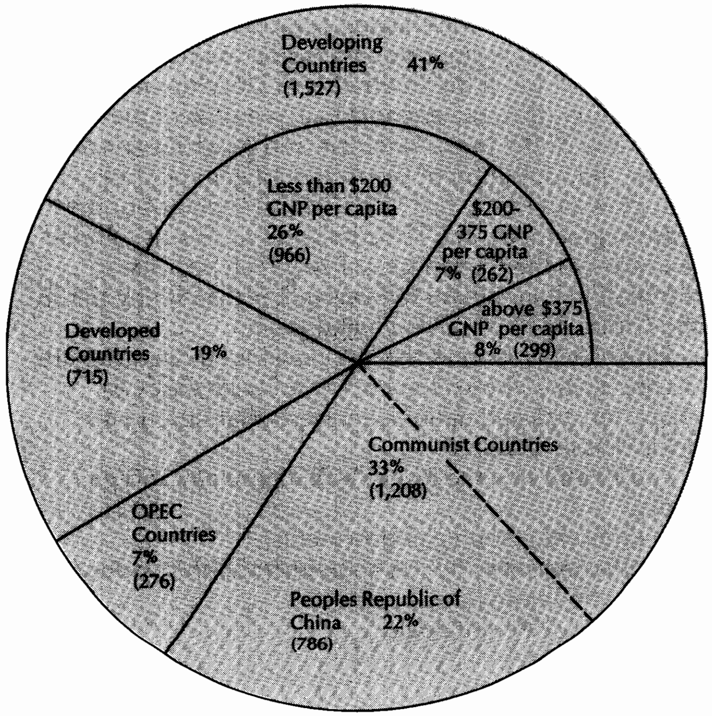
—different resource endowments;

—different sizes, hence frequently different roles to play on the international scene;

—hence, different goals.

Figure 1

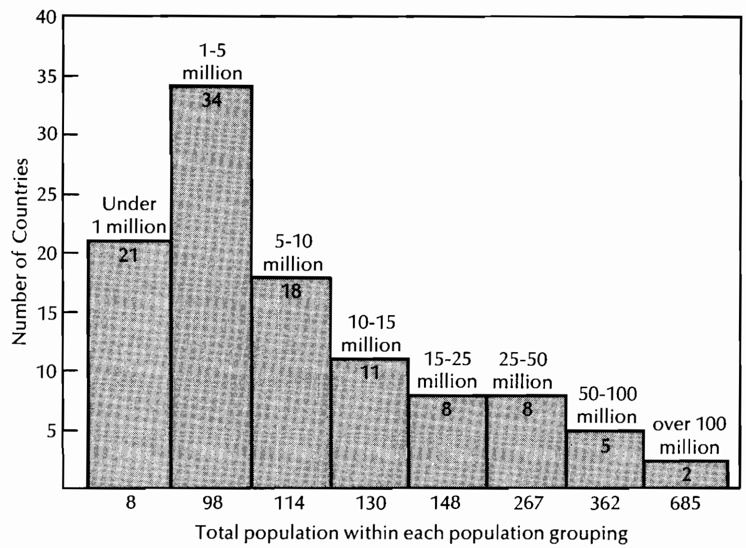
Population by Income Groupings
(1972 data—millions of people)



Source: World Bank Atlas, 1974

Figure 2

Number of Developing Countries by Population Size
(1972 data—millions of people)



Source: World Bank Atlas, 1974; UN Monthly Bulletin of Statistics, February 1975

Some less-developed countries are oil producers and some are consumers. These two groups may not berate each other publicly, they may maintain unity in the United Nations and other forums, but they undoubtedly vigorously negotiate with each other based on their differing needs. Some less-developed countries are primary commodity exporters, some of processed and manufactured goods; some export commodities whose prices are high, such as oil, and some whose prices are relatively low, such as tea; some need concessional capital assistance, some need no development assistance but opportunities to export; some seek foreign investment, some shun it.

Given these different pulls of developing countries—the drive for unity versus objective conditions of diversity; a frequent confrontational posture in multilateral forums but cooperation in bilateral matters; some with significant international roles, others really with practically none—what implications can be drawn for the U.S. policy approach towards these countries?

1. Without being overwhelmed by it, the United States must be politically sensitive to what motivates the less-developed countries' drive for unity. The behavior of the less-developed countries is in part a product of and counter-pull to western thinking on such concepts as maintaining a balance of power and of dividing to conquer.

2. Unity of the less-developed countries often is achieved by including each country's pet desire or program. As a result, the agendas of international economic meetings designed to deal with relations between less and more-developed countries, or the many declarations of less-developed countries on these issues in recent years, are almost invariably long. Just because the less-developed countries agree to support each others' demands does not imply that these demands are justified or that they should be granted.

3. What it does impose on U.S. decision-making is a need to reexamine our own policies—to stay with what we have if we think it is correct, to alter if we decide that is wise, to make counter-proposals if our analysis leads to this conclusion. The agenda for reexamination is long; it covers relations between the U.S. and other developed

countries and the less-developed countries in trade in manufactures and commodities and invisibles, investment, debt, aid, security of supply, technology, and other areas.

4. Alongside the need to understand the drive for unity among less-developed countries, and, indeed, overriding this, our programs must differentiate among countries. For example:

—richer less-developed countries might most need access to our markets for their manufactured goods;

—the richer less-developed countries might need access to our capital markets and not concessional assistance;

—poorer basic commodity exporters might seek means to maintain their foreign exchange availabilities so that their development programs are not unduly prejudiced by large price fluctuations;

—many countries seriously affected by recent oil and food price increases may require emergency assistance.

5. Put differently, global solutions in any given functional area covering all countries which describe themselves as less-developed invariably will be wrong for many of these countries. This requires that the U.S. orchestrate its policy instruments, choosing the right ones as they affect particular countries, to have a consistent approach among all policy instruments as these affect our relations with any given country.

6. Finally, it requires precise definition of our national objectives towards less-developed countries as a whole, but more particularly, in our relations with any given country.

In addition to the substantive issues with which U.S. policy must deal, there are institutional implications stemming from these differing pulls of developing countries. Voices have been most shrill, and the confrontation most severe, in general-purpose organizations, such as the United Nations General Assembly, the United Nations Conference on Trade and Development and the United Nations Industrial Development Organization. Confrontation has been least severe in special-purpose organizations which have a defined economic focus and purpose, such as the World Health Organization or the International Monetary Fund, the World Bank Group, and other international financial and development institutions. The atmosphere has fluctuated between workmanlike and confrontational in the GATT, but mostly it has been workmanlike.

The confrontational atmosphere also has been most tense in those general-purpose institutions in which each country, regardless of economic size or financial contributions, has one vote. The ambiance has been least confrontational in the weighted-voting institutions, such as the financial institutions; and it has been somewhere in-between in the GATT, which does not have weighted voting, but which in a trade negotiation has an implicit weighting so that the give-and-take of trade concessions relates directly to a country's position in world trade.

One general policy conclusion would seem to be that both kinds of institutions are needed to permit the general debate to proceed, even if with confrontation, and more specialized bodies to do their designated jobs.

The remaining chapters in this report deal more specifically, both analytically and quantitatively, with particular areas of U.S. economic interaction with less-developed countries.

III

Principal Developments in the Less-Developed Countries in 1974

Less-developed countries were deeply affected by the many great changes in the economic situation of the world in 1974. Some of the changes were of a cyclical nature and others may prove to be long lasting. The overall effect was to differentiate even further the economic situations of less-developed countries with each other and with developed countries, including the U.S. By the end of 1974, U.S. policy had not fully adjusted to these changed circumstances. It will be the task of the DCC in 1975 to assist in making policy adjustments in a coordinated manner.

The most important development in 1974 was the great increase in petroleum prices. The supply problems of early 1974 had a temporary effect on some less-developed countries, but the three-fold price increase since 1973 has produced dramatic and long-lasting effects. The immediate effect was to produce two sharply defined groups of less-developed countries—those most seriously and adversely affected by higher oil prices (the MSAs) and the major oil exporters (the members of OPEC). A large number of less-developed countries fits in between these two groups, and the effects on them will depend in large measure on the cooperative international arrangements that emerge.

A second important development was the high prices and, for a time, short supplies of grains, other agricultural products, and fertilizers, which are having large impacts on the food availabilities, terms of trade, and balance of payments of most less-developed countries.

Figure 3

Estimated F.O.B. Selling Price of Persian Gulf Crude[1]

$/Barrel

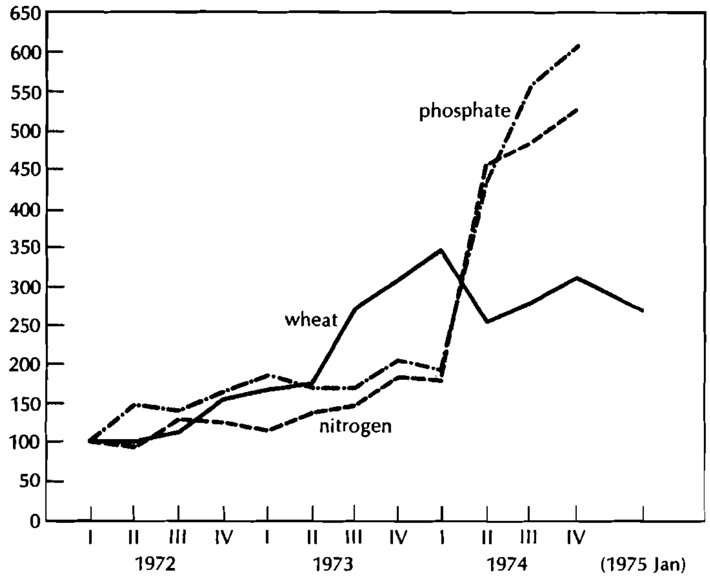
	Average Price	Average Government Revenue
1970		
1st Quarter	1.36	.91
2nd Quarter	1.36	.91
3rd Quarter	1.36	.91
4th Quarter	1.41	.96
1971		
1st Quarter	1.59	1.14
2nd Quarter	1.74	1.29
3rd Quarter	1.78	1.33
4th Quarter	1.78	1.33
1972		
1st Quarter	1.87	1.42
2nd Quarter	1.90	1.45
3rd Quarter	1.90	1.45
4th Quarter	1.90	1.45
1973		
1st Quarter	2.12	1.52
2nd Quarter	2.31	1.71
3rd Quarter	2.51	1.91
4th Quarter	3.83	3.23
1974		
1st Quarter	10.83	9.24
2nd Quarter	10.83	9.24
3rd Quarter	11.05	9.37
4th Quarter	10.67	10.09
1975		
1st Quarter	10.46	10.12

[1] 34° Gravity Saudi Arabian Light

Source: AID

Figure 4

Indices of
Wheat and Fertilizer Prices
By quarter, 1972-1974
(1972 1st Quarter = 100)



Wheat: No. 1 hard winter wheat, ordinarv protein, f.o.b. Gulf ports
Nitrogen: Urea, prices paid by AID, f.o.b. country of origin
Phosphate: Combined TSD and DAP, prices paid by AID f.o.b. country of origin

Sources: USDA, AID

A final important development was the decline in production in the developed countries following the rapid worldwide expansion of 1973. This complicates the foreign exchange problem of the less-developed countries since the demand for their exports has dropped sharply. The year started with high commodity prices and strong demand for imports by the developed countries. It ended with commodity prices falling rapidly, and developed country import demands for primary commodities and other goods waning. In 1974, the trade deficit of less-developed countries other than oil exporters was $26 billion, compared with $12 billion in 1973. If it can be financed, this deficit is likely to grow in 1975.

The group of countries whose development prospects worsened most includes more than 30 countries with a total population of about one billion. Any such listing of countries is necessarily arbitrary, but the overall size and distribution of the MSA problem will not change greatly with the exact listing used. The list of 33 MSA countries prepared by the United Nations is the best known. Geographically these countries include those of the South Asian-Indian subcontinent, which have just under 80 percent of the total MSA less-developed country population, about 25 countries in Africa with about 15 percent of the total population, the countries of Indochina with three percent of the population, and a half dozen or less countries in Latin America with under three percent of the population. These countries have low per capita incomes. Many are small in territory and have limited natural and human resources for rapidly developing exports. Many are net importers of food grains and have been hard hit by the world grain situation. Many lack the funds to maintain, let alone expand, fertilizer use to increase domestic food production. Some of the larger countries in the group have the potential both for greater domestic self-sufficiency in energy and for greater export volume but in the past have not emphasized these goals in their development policies and programs; this subgroup is small in number but accounts for most of the population, national income, and balance of payments shortfalls of the MSA and related countries. A concerted international effort is needed to assist all these countries in developing their long-run economic potentials while providing financial assistance in adequate amounts during the current situation.

There is a second large group of somewhat over 40 countries whose overall development prospects have been less severely affected or in a few cases may even have improved slightly. Some of these countries are close to self-sufficiency in energy and petroleum; others are sizeable exporters of basic commodities whose prices have remained high. Some have been aggressive in increasing exports of manufactured and processed goods to the developed countries in recent years and have been able to meet the petroleum crisis thus far with high foreign exchange reserves, increasing exports, and access to the capital inflows from the developed countries. These countries thus have a major stake in the economic health of the world economy.

Finally, there are the 13 countries of the Organization of Petroleum Exporting Countries (OPEC), all of which

Figure 5

OPEC Countries Foreign Exchange Reserves and Per Capita GNP

	Foreign Exchange Reserves (millions of dollars)		Per Capita GNP (dollars)	
	End of 1974	Increase During 1974	1973	1974
Algeria	1,689	546	350	530
Ecuador	350	109	320	420
Gabon[1]	n.a.	n.a.	900	1,540
Indonesia	1,492	685	80	100
Iran	8,383	7,146	520	940
Iraq	3,273	1,720	430	930
Kuwait	1,397	896	4,100	8,500
Libya	3,616	1,489	3,000	5,800
Nigeria	5,629	4,511	150	230
Qatar	n.a.	n.a.	3,300	> 10,000
Saudi Arabia	14,285	10,408	980	2,900
United Arab Emirates	n.a.	n.a.	9,000	> 10,000
Venezuela	6,529	4,109	1,150	1,850

[1] Associate member

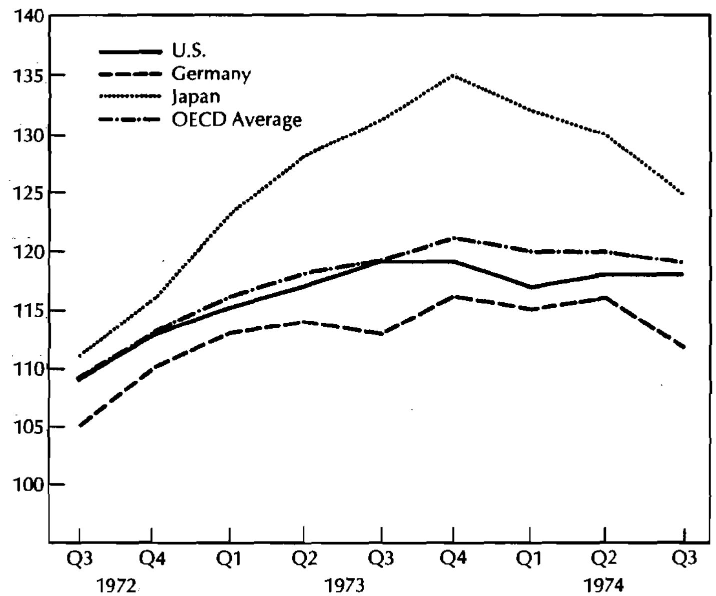
Source: IMF

greatly increased their foreign exchange earnings in 1974. The OPEC group is not homogeneous. Its members range from Saudi Arabia and other Arab countries with very high per capita earnings and limited capacity to absorb imports, to a middle range of countries such as Iran and Venezuela with larger populations and absorptive capacities, to Algeria, Ecuador, Nigeria and Indonesia, whose per capita incomes, including oil revenues, still are low. Although the OPEC countries are heavily dependent on goods and services from the developed countries for further modernization of their social and economic life, many also have achieved sufficiently large foreign exchange earnings that they have been able to undertake foreign assistance programs to other less-developed countries. Cooperation between the "new rich" OPEC countries and the "old rich" industrial countries in helping the MSA countries as well as the other developing countries is one of the current challenges of interdependence.

Since the most important developments of the last year have increased the diversity of the situation in the less-developed countries, U.S. policy must be more discriminatingly designed to take this into account. The DCC plans to examine this in 1975.

Improved coordination and adjustment of U.S. policies as they affect the diverse development situations of the less-developed countries are now being carried out in a period of economic crisis in the world economy which is forcing all the developed countries to revise their economic policies. The highest priority is properly being given to stopping the downturn in the economies of the

Figure 6
Industrial Production in OECD
Member Countries
(Seasonally adjusted, 1970 = 100)



Source: OECD Main Economic Indicators, February, 1975 developed countries. If the developed countries do not restore high levels of activity in their economies or if economic cooperation founders, the adverse effects on the prices and volumes of exports from the less-developed countries and on flows of capital to them will be sever.

It would be equally unfortunate if the policies which the developed countries adopt to meet their problems achieve their results at the expense of the less-developed countries.

The relations of the developed countries as petroleum consumers with the petroleum producers are of obvious importance. While the major petroleum exporters are economically less developed, their conditions of development differ widely, and they are still dependent on the U.S. and the other developed countries for many things essential to their development. While few of the OPEC countries, if any, currently require concessional assistance, the success of the U.S. and other developed countries in supplying their development needs efficiently will strongly influence future relations with these countries. If they are developing their economies successfully, they should be willing to take on more of the responsibility to provide assistance to the other less-developed countries and share the burden now carried by the OECD countries.

An increased effort must also be made to grow more food, both in the less-developed countries and in the U.S. and other developed countries. A three-pronged attack of providing assistance to the less-developed countries for increasing agricultural output, of building up world food stocks, and providing emergency assistance to less-developed countries hit by droughts, floods and other disasters is now under way.

Another subject of importance for coordination of U.S. policy will be the situation in the international commodity markets. The developed countries are interested in access to needed commodities at reasonable prices, while producers are concerned with assured markets, at what they consider to be reasonable and generally stable prices. In addition to the actions under way for food commodities, other agricultural and natural resource commodities will be the subject of intense study during the coming year.

IV

The Magnitude of U.S. Economic Relations With Less-Developed Countries

This section provides a short quantitative summary of U.S. economic relations with the developing countries as a basis for assessing their relative importance. This summary omits many important non-quantifiable factors in U.S. relations with the developing countries.

A. *Capital Flows*

1. *Total Flows* Viewed in other than their absolutc magnitudes, the total net flow of resources in 1973 was six-tenths of one percent of the U.S. gross national product, and official development assistance was less than a quarter of one percent.

Figure 7

U.S. Net Flow of Resources to Developing Countries and Multilateral Agencies, 1971-1973
($ millions)

	1971	1972	1973
Total new flows	6,888	7,574	8,272
Official development assistance	3,324	3,349	2,968
Other official flows	180	196	477
Private Capital	3,384	4,029	4,827

Source: 1974 DAC Chairman's Report

2. *Official Flows* As shown in the following table, official development assistance of the U.S.—bilateral assistance under the Foreign Assistance Act, contributions to multilateral agencies, PL 480 grants and loans, and Peace Corps programs—accounted for 36% of the total U.S. capital flow to underdeveloped countries in 1973, a decline from the nearly 50% share in 1971.

Amounts of development assistance appropriations were:

Figure 8

U.S. Budget Resources Devoted to Development
($ millions)

	FY 1973	FY 1974	FY 1975
AID	1,664.3	1,548.6	2,037.3
PL 480	1,165.0	1,152.0	1.617.0
Peace Corps	81.0	76.0	77.0
Other	78.0	97.0	118.0
International Financial Institutions	570.0	644.0	751.0
Total	3,558.3	3,517.6	4,600.3
As percent of Federal budget	1.29	1.13	1.4
As percent of GNP	0.29	0.26	0.33

Source: DAC U.S. Annual Aid Review for 1974, amended for supplemental request and for changes in PL 480.

a) Bilateral Assistance:

The AID portion of the budget shows a rising share for categories other than development assistance. The distinctions, however, are not clearly defined since much of Supporting Assistance, the Indo-China Postwar Reconstruction Fund, and the Middle East Special Requirements Fund is, in fact, used to help in the development of countries of immediate concern to us.

Figure 9

The AID Budget
($ millions, new obligational authority)

	FY 1973	FY 1974	FY 1975
Bilateral Development Assistance	732.5	585.0	574.0
Contributions to International Organizations	127.0	145.5	139.2
Other	204.8	255.6	124.1
Total Development Assistance	1,064.3	986.1	837.3
Supporting Assistance	600.0	112.5	660.0
Indochina Postwar Reconstruction	0	450.0	440.0
Middle East Special Requirements Fund	0	0	100.0
Grand Total	1,664.3	1,548.6	2,037.3

Source: AID

AID bilateral development assistance, loans and technical assistance grants, are responsive to the Congressional desire to give priority to the poor majority and to focus on food nutrition, population and health, and education and human resources.

Figure 10

AID Assistance in Functional Categories

	FY 1974 Obligated		FY 1975 Appropriated	
	$ millions	%	$ millions	%
Food and Nutrition	284.0	49	300	52
Population Planning and Health	135.0	23	125	22
Education and Human Resources	89.0	15	82	14
Selected Development Problems	40.5	7	37	6
Selected Countries and Organizations	36.5	6	30	5

Source: AID

The PL 480 program has been expanded from the FY 1975 Congressional Presentation level of $995.9 million to $1,617 million to meet expanded food import needs caused by the weakness of the South Asian monsoon and the general increase in world prices, including food prices, which have caused severe balance of payments and nutritional problems in many developing countries.

b) Commercial Lending:

Official U.S. commercial lending to developing countries for economic purposes is relatively small, less than 6 percent of all U.S. capital transfers in 1973 and only 16 percent of all public capital transfers. Made up mainly of loans from the Export-Import Bank and commercial-term CCC credits, these go principally to the better-off developing countries. This is so because of the concern of the lenders with credit worthiness of poor nations and the concern of both borrower and lender with repayment burdens.

c) Multilateral Contributions:

The U.S. plans to contribute $890 million this fiscal year to international organizations engaged in development activities, $139 million through the AID budget. It will go to several agencies of the United Nations elsewhere, and to the International Development Association (IDA), The Inter-American Development Bank (IDB), and the Asian Development Bank (ADB). The U.S. share in IDA financing was 38 percent in the third replenishment (and falling) and to concessionary financing windows of the IDB and ADB, 71 percent and 9 percent respectively. We have provided 25 percent of the IBRD's ordinary capital, 40 percent of the IDB's and 9 percent of the ADB's.

These agencies are major providers of development capital; in FY 1974 IDA loaned $1,095 million in 50-year, three-fourths-of-one-percent service charge loans to poor nations, and the IBRD loaned $3,218 million on its regular terms. (In 1974 the interest rate on the latter was raised to 8.5 percent.) In 1974 the IDB loaned $636 million on its regular terms and $475 million on concessional terms, and the ADB committed $375 million regular and $173 concessional. Thus, these institutions have reached an annual lending level of nearly $6 billion and the level is rising, particularly in current dollars.

The United Nations budgeted more than $900 million in 1973 for agencies involved in development or humanitarian assistance. The average U.S. contribution to these agencies, which include the UN Development Program, the World Food Program, the UN Family Planning Program, UNRWA, UNICEF, and many others, was a little less than one-third.

3. *Private Capital* U.S. private capital flows to less-developed countries were 59 percent of all U.S. capital flows in 1973. The U.S. encourages this by several means; two agencies, OPIC and AID through its Housing Investment Guarantee Program, are specifically charged with this task. OPIC's main instrument is investment insurance —nearly a billion dollars worth was written in FY 1974. The Housing Investment Guarantee Program had authorized $553 million of its $930 million authority by the end of FY 1974.

U.S. private flows to developing countries in 1973 were as follows:

Figure 11

U.S. Private Flows to Developing Countries, 1973

	$ millions
Net direct investment	2,707
of which: new investment	(1,198)
reinvested earnings	(1,509)
Banks and other monetary institutions, net	517
Insurance companies and other monetary sector movements, net	188
Net investment in securities	510
Grants by U.S. voluntary agencies	905
Total	4,827

Source: Department of Commerce, Balance of Payments Division

B. *Trade*

Developing countries accounted for 29.8 percent of total U.S. imports and 32.1 percent of exports in 1973. However, in proof of the well-known tendency of trade to increase with development, only about 10 percent of the trade both ways with developing countries was with the poorest, those with per capita GNP below $200. The very poorest, with per capita GNP of $100 and below, accounted for only about one to one-and-a-half percent of our trade with developing countries.

Figure 12

U.S. Trade with Developing Countries
($ millions)

	1970	1971	1972	1973	1974
Imports total	10,998	12,206	13,979	20,580	39,471
Commodities	6,907	7,188	8,251	n.a.	n.a.
(of which:					
POL)	(1,940)	(2,399)	(3,034)	(5,335)	(19,161)
Processed Agricultural Commodities	486	553	602	n.a.	n.a.
Manufactured Goods	3,237	3,941	4,505	n.a.	n.a.
Other	368	524	621	n.a.	n.a.
Exports, total	13,319	13,622	14,590	22,864	32,698
Food	1,715	1,732	2,121	n.a.	n.a.
Fertilizer	132	128	223	n.a.	n.a.
Other	11,472	11,762	12,246	n.a.	n.a.
Balance	474	1,416	611	2,284	6,773

Source: DAC Annual Aid Review of the US, 1974

Even including petroleum, it is noteworthy that the U.S. had a favorable balance of trade with developing countries in each of the four years 1970-1973. In 1973 the U.S. earned in exports to the developing countries $2,285 million more than it paid for imports from them. In 1974, because of the increase in oil prices, the trade balance reversed. However, if trade with the oil-exporting countries is excluded, the U.S. had a 1974 trade surplus with developing countries of $5.6 billion.

The U.S. imported 19 percent of total developing country exports in 1973. The U.S. is the largest single importer of most of the primary commodities on which developing countries depend for income. Many of these commodities are essential to U.S. industry. The U.S. imports all of its tin, 95 percent of its manganese, 87 percent of its bauxite, 93 percent of its platinum, 45 percent of its potassium, 44 percent of its tungsten, and 51 percent of its zinc, to cite some examples. We are also dependent on developing countries for many products of tropical agriculture, such as rubber, copra, coffee, cocoa, tea, and jute.

In addition, U.S. payments to and receipts from developing countries for shipping, insurance, tourism, and remittances are large, as are receipts for royalties, profits and interest.

C. *Summary*

DAC countries, oil exporters and socialist countries committed $20-25 billion in bilateral and multilateral assistance during the past year. Approximately one-fifth of the total assistance was provided by the U.S. This is close to the magnitude of developing countries' earnings from us in trade and invisibles so that the U.S. provides about 20 percent of the foreign exchange received by the developing world.

V

Development Assistance

Developing countries' requirements for external capital increased dramatically in 1974. The combination of increased oil, food, fertilizer and capital goods prices, and a fall in demand for their exports as a result of reduced world-wide economic activity increased the current account balance-of-payments deficit of non-oil exporting developing countries by an estimated $14 billion to a deficit of $24 billion. The increased prices of petroleum alone raised the developing country import bill by approximately $8 billion to a level of $12 billion; this raised the share of oil in total less-developed country imports from an average of 5-10 percent in 1973 to close to 20 percent in 1974. Between 1972 and 1974 less-developed country imports of major grains increased from $2 billion to an estimated $8 billion. Recently, however, food prices have declined to some extent.

The increased current account deficits resulting from these changes must be covered by increased public and private capital flows, including flows from oil producers, and through adjustments by the developing countries themselves. The World Bank has estimated that in order for the less-developed countries to achieve an average 2.5 percent annual growth rate in per capita income, disbursements of official capital, concessional and other, will have to increase from $16 billion in 1974 to $54 billion in 1980.

A. *The Most Seriously Affected Countries (MSAs)*

Soon after the onset of the energy crisis, the international development community began analyzing the implications of energy, food and fertilizer price increases, and the emergency financing needs of the countries least able to cope with this rapidly changing economic environment. This group of countries has become known as the "most seriously affected" or MSA countries. All (1) sustained a significant increase in import costs as a result of the high costs of oil, food and fertilizer, without fully offsetting increases in export earnings; (2) have few financial resources and limited ability to obtain financial resources with which to cope with their basic balance of payments requirements; and (3) have low per capita incomes.

The United Nations identified 33 countries as most seriously affected. The criteria used by the UN to select these countries were: (1) a per capita income of $400 or less in 1971; and (2) a projected overall balance of payments deficit in 1974 or 1975 equivalent to 5 percent or more of estimated imports. Although the UN listing does not adjust as individual country positions change, it is being used as a reference point in most international forums addressing this theme to discuss the critical problems faced by many countries.

Using the UN list, the current account balance of deficit MSAs is estimated to have been $5.5 billion in 1974, an increase of $3.5 billion over the 1973 deficit of $2.0 billion. This increasing current account deficit results primarily from the fact that import costs increased by 50 percent in 1974 while export earnings increased by only 24 percent. Over one-half of the increased import bill derived from the increased costs of oil and food, with oil increasing by $2 billion. Assuming that it can be financed, the current account deficit of the MSAs in 1975 is expected to deteriorate further, increasing to over $6 billion, as a result of continuing large food and other import requirements and the reduced potential for export growth resulting from slower economic growth in developed countries.

The basic balance deteriorated between 1973 and 1974, but fell less than the current account balance as a result of increased long-term capital inflows. Official capital flows to the MSAs increased by over $1.5 billion in 1974. Approximately one-half of this increase was accounted for by the oil-exporting countries, with a large portion going to India and Pakistan. The traditional donor countries, including the U.S., also increased their assistance to the MSAs—although in some instances such increases had been planned prior to the crisis. Attention to the MSA plight is expected to result in further increases in total net flows to them in 1975, placing these at over $4.4 billion, more than twice the level in 1973. In spite of these capital flows, the basic balance of the MSAs, which stood at a positive $0.1 billion in 1973, fell to a negative

$1.8 billion in 1974 and is expected to remain at approximately that level in 1975.

The development needs of these countries were being met inadequately before this economic crisis, and they are likely to remain at the core of the world's poverty problem after the current crisis has passed or been accomodated. The U.S. thus far has responded to the MSA problem principally through increased Food for Peace under PL 480.

B. *Quantity of Aid Flows*

Between 1973 and 1974 member nations of both the Development Assistance Committee (DAC) and the Organization of Petroleum Exporting Countries (OPEC) increased their gross official development assistance flows by an estimated $2 billion each (see table). While significant, these increases fell short of the requirement of the developing countries for concessional assistance. Furthermore, the assistance was not evenly distributed. The incremental OPEC aid particularly appears to have been concentrated regionally.

Figure 13

Official Development Assistance* Flows from Principal Donors
($ billion)

	1972	1973	1974
DAC Countries	8.7	9.4	(10.6)[1]
Communist Countries	(1.01)	(1.0)	(1.1)
OPEC Countries	.4	.5	(2.8)
Total	10.1	10.9	(14.5)

[1] Figures in parentheses are estimates.

* Official development assistance (ODA) consists of a minimum of 25% grant equivalent

Source: OECD and IBRD

Figure 14

Official Development Assistance Disbursement as a Percentage of Gross National Product

Country	1963	1967	1969	1971	1973
Canada	0.15	0.32	0.33	0.42	0.43
France	0.98	0.71	0.67	0.66	0.58
Germany	0.41	0.41	0.38	0.34	0.32
Japan	0.20	0.32	0.26	0.23	0.25
Netherlands	0.26	0.49	0.50	0.58	0.54
Sweden	0.14	0.25	0.43	0.44	0.56
United Kingdom	0.48	0.44	0.39	0.41	0.35
United States	0.59	0.43	0.33	0.32	0.23

Source: OECD-DAC

The decline in U.S. foreign aid in real terms has been substantial. For example, net U.S. official development aid in 1963 was $3.6 billion while the 1973 ODA deflated to 1963 prices was approximately $1.6 billion.

Figure 15

The Pattern of U.S. Bilateral and Multilateral Assistance Disbursements (ODA)
($ billion calendar year)

Loans and Grants	1965	1970	1971	1972	1973	1974 (FY)
Bilateral	3.35	2.66	2.89	2.72	2.34	2.87
Multilateral	.07	.39	.43	.63	.63	.64
Multilateral as Proportion of total	2%	14%	14%	23%	26%	22%

Source: AID Submission to DAC

As the table above indicates, U.S. official development assistance (ODA) flows remained relatively constant over the period of the early 1970s in current dollars; however, there has been a marked increase in the relative amount disbursed through multilateral channels.

1. *U.S. Technical Assistance*

Technical assistance is basic to development progress, not only to imparting the knowledge and skills necessary to development but in changing people's attitudes and goals and expanding their view of what is possible for them. It is especially important to AID's efforts to achieve broader participation in development involving those who are poor and disadvantaged and whose present outlook is narrow and circumscribed. This goal is increasingly shared by the international assistance-giving community among which are the multilateral agencies to which the U.S. contributes.

Most technical assistance is financed by grants. About 93 percent of AID's expenditures for technical assistance projects and services in FY 1974 were grant-financed. The remaining 7 percent was directly associated with capital projects and was provided under the terms of the related loans. In FY 1975 AID plans to undertake a $2 million technical assistance project in Korea on a loan basis. This could set a future pattern for relatively advanced developing countries where either the effort, though strongly desired by the recipient, falls outside the AID priority categories of agriculture, education, and health or the country program is making the transition from concessional to reimbursable technical assistance under Section 607 of the Foreign Assistance Act.

Reimbursable technical assistance paid for by the recipient is growing. In FY 1974 such programs existed in only a few countries and totalled only $6 million; in FY 1975 programs are expected in 24 countries and should total $8-10 million. This may rise in future years as the recently organized joint commissions, increase their activities. Ten U.S. Government agencies are now engaged in this program.

The newly added Section 661 of the Foreign Assistance Act allows AID to use its funds to stimulate new reimbursable aid programs and may foster further expansions in reimbursable technical assistance.

As the table below indicates, only 49 percent of FY 1975 U.S. technical assistance funds are to be used directly by AID. Nearly 41 percent are to be contributed to multilateral organizations and the proportion is growing.

Figure 16

U.S. Financed Technical Assistance Proposed for FY 1975

	$ millions	%
Programs undertaken by AID directly	234.7	48.8
Reimbursable technical assistance (Section 607)	10.0	2.1
Contributions to U.S. Voluntary Agencies	41.4	8.6
Total Bilateral Aid	286.1	59.5
Contributions to Regional Organizations	80.9	16.8
Contribution to UN Agencies	113.6	23.6
Total Multilateral Agency Contribution	194.5	40.5
Total U.S. Financed Technical Assistance	480.6	100.0

Source: Dept. of State and AID

Technical assistance is needed in the development process from the earliest stages of economic activity through the most advanced. Since the U.S. is the world's technological leader in depth as well as breadth of expertise and personnel resources, it is the primary source of supply of this resource for the developing world. Technical assistance is required in grant form by the poorest nations; it can properly be supplied through credits in other circumstances. But there are examples of less-developed countries which have ample financial capital resources yet require substantial and varied technical assistance. Where the governing constraint on the development process is a shortage of knowledge and expertise, the U.S. can play a fundamental role in expediting change. Thus, the U.S. can contribute to the well-being of the more affluent developing nations who are newly rich but have a narrow domestic base as well as aid "graduate" countries.

For "graduates," or for the countries rich in foreign exchange, the requisite technical aid can properly flow from American private or official sources on a reimbursable basis. Reimbursable technical assistance arrangements are an important component of the emerging special bilateral cooperative arrangements with a country such as Saudi Arabia. There are potential benefits for the U.S. in these relationships. Similarly for countries such as Nigeria or Indonesia, which would have very large investment absorptive capabilities if the shortage of trained manpower were alleviated the U.S. could provide the critical component and thereby participate in the development programs through technical assistance.

2. *Multilateral and Bilateral Channels for Assistance*

To achieve its several purposes, the U.S. provides aid directly through country to country programs or by pooling resources in multilateral institutions such as the World Bank Group, the regional development banks for Latin America and Asia, and various United Nations programs, such as the United Nations Development Program. There are also coordinating mechanisms for bilateral and multilateral programs such as consultative groups or consortia. In 1973, U.S. official development assistance net disbursements (grants and loans with more than a 25 percent grant equivalent) totaled $3 billion, of which 79 percent was via bilateral channels and 21 percent multilateral. (The multilateral percentage has increased from less than 5 percent 10 years ago and continues to grow.) This is close to the proportions for all other developed countries combined in 1973, which were 74 percent bilateral and 26 percent multilateral.

Bilateral assistance consists principally of AID loans and grants and PL 480 agricultural commodity agreements. It can be concentrated for specific purposes and controlled by the United States. Assistance provided by the U.S. through the World Bank Group, regional banks, and the United Nations helps to secure complementary assistance from other donor countries and provides a means for cooperation and assistance burden sharing. The multinational pooling of resources permits funding of larger projects while promoting coordination of assistance. The use of consortia and consultative groups facilitates coordination of bilateral and multilateral assistance. The less-developed countries have generally favored keeping open both bilateral and multilateral aid channels and find that the various sources of assistance provide them with flexibility and freedom from dependence on a single source.

The relative quantities of U.S. resources that should go via the bilateral aid program and via the various multilateral institutions and U.S. influence over the lending policies of the multilateral institutions are continuing policy questions.

Figure 17

U.S. Multilateral Development Assistance*
($ millions)

	U.S. Fiscal Years					
	1970	1971	1972	1973	1974	1975[1]
World Bank Group						
IBRD	—	—	—	1	12	—
IDA	55	38	78	125	230	359
Asian Development Bank	10	10	17	21	10	22
Inter-American Development Bank	159	153	180	238	195	217
African Development Bank	—	—	—	—	—	—
United Nations	150	179	293	218	144	150
TOTAL	374	380	568	603	591	748

[1] Projected

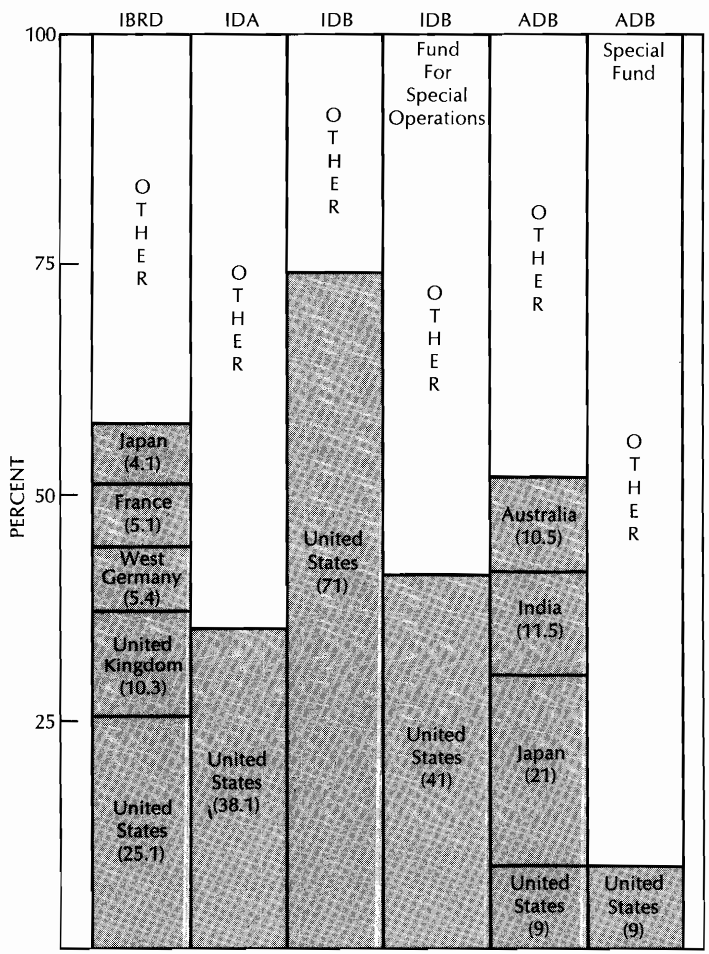
* Disbursements except for UN which are obligations

Source: U.S. Treasury

There is ambivalence regarding U.S. participation in multilateral institutions. We favor using them, since they do facilitate sharing of the aid burden and theoretically involve us less in the internal affairs of others. However, since we do wish to have a voice in how our funds are spent, issues arise on the extent to which the U.S. should try to influence or control the lending policies and operations of multilateral institutions. At the direction of Congress, the U.S. has sought additional auditing and evaluation of multilateral projects to ensure efficiency and effectiveness in their operations. Questions also have arisen on lending for specific countries where the U.S. has adopted special policies. Thus, through Congressional initiative, the U.S. must vote no on all IDA loans to India given the latter's nuclear explosion and lack of adherence to the non-proliferation treaty. There are provisions in our legislation relating compensation for expropriated private U.S. property and loans in multilateral institutions. The issue can involve apparent dilemmas. The more we try to make lending policies of multilateral institutions responsive to bilateral U.S. interests, the more others will be tempted to do the same and the less viable they will be as multi-lateral institutions. The less we seek to exert our influence on lending criteria for the multilateral institutions, the greater the likelihood of contradiction between bilateral and multilateral lending strategies for some countries.

Figure 18

Relative Subscriptions to Multilateral Development Finance Institutions



Source: Treasury

The present importance of the multilateral financial institutions is not clearly seen unless their other activities in addition to official development assistance are examined. Using the guarantees of callable capital provided by the U.S. and other members, the multilateral lending agencies borrow large amounts of capital on private markets which they lend for projects in the less-developed nations. The gross volume of this lending, which exceeds their gross volume of concessional lending, is an important factor for development and increases the importance of the multilateral institutions to the members.

The IMF, not properly thought of as a development institution, is also increasingly active in lending to the less-developed countries with its oil facility loans (or drawings, as they are called in the IMF), export earnings shortfall loans, buffer stock loans, and standby agreements. Although the IMF lends at relatively hard terms and for much shorter periods than the multilateral lending institutions, it is very important in gross volume to lending to less-developed countries.

C. *New Multilateral Initiatives*

In response to the changing international monetary situation, the IMF created the Interim Committee to deal with developments in the international monetary system. Concurrently, responding to the worsening condition of the non-oil exporting developing world, the IMF in cooperation with the IBRD created a Joint Committee for the Transfer of Real Resources (the Development Committee). Both those organizations potentially can have important effects upon the pace and direction of the evolution of the developing world.

The Interim Committee approved an oil facility of SDR 5 billion for 1975 and endorsed a proposal for a subsidy to reduce the interest rates for the poor developing countries. The subsidy is to be supported by contributions from oil exporters or developed countries; however these are yet to be committed. The developing countries made extensive use of the oil facility in 1974 when the credits were provided at terms of 7 percent and 7 years.

The Interim Committee also approved an increase in IMF quotas which would double the quota share of the major oil exporters as a group and maintain the proportional collective share of the other developing countries. Continued study of the SDR—aid link and other methods of transferring real resources to the less-developed nations was also discussed, as was study of amendments to the Articles of Agreement of the IMF to improve means to finance international buffer stocks of primary products and improvements of facilities for compensatory financing of export fluctuations.

The Development Committee also considered the immediate prospects of the developing countries. This Committee invited study of the creation of special trust funds to channel concessional assistance, study of a "third window" to provide credits on terms intermediate to those of the World Bank and its concessional loan window, the International Development Association, examination of developing countries' total capital requirements and means of access for the developing countries to world capital markets.

The third window proposal would create a loan facility within the World Bank to provide project credits to the poorer of the developing nations with terms lower than conventional Bank terms (now 8.5 percent). The interest subsidies for these loans would be made possible through special grants while the loans would be provided through customary Bank lending operations. Several nations have indicated willingness to contribute to the subsidy. The size of the third window, minimum qualifications for its use, how decisions will be made on who receives subsidies, sharing the burden of subsidies, and many other technical aspects of the proposal are under study and negotiation. The developing nations desire the third window if it will supply additional benefits at better terms; however, since it is only now under study, it is not clear what will emerge. The U.S. has neither opposed nor supported this proposal to date.

The U.S. has proposed a temporary special trust fund for the poorest developing countries in recognition of their serious current adjustment problems. Total resources of the trust fund during the first year might be $1.5 to 2 billion. Contributions might be provided from use of a portion of the gold held by the IMF and/or from voluntary contributions. Only countries with low per capita income would be eligible to borrow from the trust fund. This proposal is being studied by the International Monetary Fund and the World Bank.

D. *Developing Countries in World Capital Markets*

In their search for additional external sources of capital, developing countries have been giving increasing attention to the possibility of directly tapping world capital markets. It is desirable that those developing countries which are able to do so utilize these markets and eventually that they come to rely essentially on this source for capital requirements. In the short-run some countries may have been forced to overextend in this market.

In recent years several developing countries—mainly comparatively advanced ones—have greatly increased their drawing on private capital markets. However, developing country borrowing in national long-term bond markets has remained limited. In 1974, non oil-exporting developing countries sold roughly $220 million of bond issues abroad, down from about $500 million in 1973. Instead most of the recent dramatic expansion has been in the form of medium-term bank credits from the Euro-markets. In 1974, publicized Euro-currency credits to non-oil importing developing countries were $7 billion, up slightly from the previous year, but up substantially compared with $1.5 billion in 1971. To a great extent this expansion has substituted for or replaced other forms of credit such as supplier credits or loans from international institutions.

It is not difficult to understand some of the reasons for this expansion. A relatively new and rapidly expanding source of private funds was becoming available, largely unregulated, and unfettered with the many restrictions which have inhibited developing country access to national markets. Credit from this source is untied, leaving borrowers free to shop for the best bargains in needed imports; dealings are at arms length, free from political coloration and policy conditions; obligations are usually denominated in dollars, considered in some cases to have a smaller exchange risk for the borrower than some other currencies; and in some instances, borrowers have been able to refinance existing loans at lower rates or more favorable amortization terms.

At the same time there are risks and drawbacks for developing countries in heavy dependence on the Euro-market. The relatively easy availability of credit and less stringent lending standards may have tempted some borrowers to overburden themselves with external debt. Their medium-term credits have floating interest rates. While the commitment period is typically for three to eight years, the loans are renewed at six-month intervals at which time interest rates (and sometimes other conditions) will be adjusted to current market conditions. This leaves the borrowers a substantial burden of risk.

During 1974 there was a sudden transformation in the pattern of international credit flows arising out of the increase in oil prices and the resultant swelling of surplus oil earnings. A large proportion of these volatile funds was channeled into the Euro-banks, while, at the same time, the need to finance the sharply increased current account deficits of oil importers led to increased demands for medium-term financing. Aside from worries about the volatility of the market, and pressures on the intermediation capacities of the banks there was also some worry that the jump in demand for credits by industrialized countries might tend to crowd out developing countries with similar needs. However, the market accommodated the rapid growth, and the fall-off in credit demand by the oil-exporting countries made room for a substantial (37.8 percent) rise in publicized credits to non-oil exporting developing countries even as credits to industrialized countries were rising by 49.6 percent.

Figure 19

Publicized Eurocurrency Credits
($ millions)

Selected Countries	1973	1974
Bolivia	6	52
Brazil	718	1,438
Egypt	0	230
Korea	142	222
Jamaica	36	95
Panama	251	101
Philippines	179	869
Zambia	150	—
Zaire	287	105
Total (all non oil-exporting developing countries including Spain, Greece and Yugoslavia)	6,104	8,410

Source: IMF Survey, February 17, 1975.

Given the drawbacks cited above, and although the Euro-currency market will no doubt continue to be an important and beneficial source of funds for developing countries, it would seem desirable to try to provide alternative sources of private portfolio borrowing by these countries. This necessarily means that the ability of developing countries to successfully enter the long-term national capital markets must be increased. But there are barriers to entry into the long-term markets. In most countries, including most European countries and Japan, there is need to obtain permission from national authorities to negotiate long-term credit. Secondly, there are numerous regulations on public bond flotation including information disclosing requirements, which are especially difficult for inexperienced developing country borrowers. This is true particularly in the United States. Also, both in the United States and abroad, financial institutions that are important sources of long-term capital, such as insurance companies and pension funds, are under restrictions severely limiting the amount of developing country or other foreign issues in their portfolios. In the United States this is largely of potential rather than present importance, since most institutions are not near their limits. Rather, the prime factor for these institutions is a reluctance to purchase less-developed country bonds, which are perceived to be excessively risky and lacking in liquidity. To some extent, this reflects lack of relevant knowledge and information, and lack of experience with less-developed country issues. Insurance companies have the additional concern that industry valuation committees will tend to give low evaluations to securities of relatively unknown issuers. Normal risk premiums have not been sufficient to compensate these institutional lenders for the additional difficulties involved in purchasing substantial amounts of developing country issues. *Other* capital transactions (short and long-term) between American banks and non-oil developing countries increased in 1974.

Figure 20

Net Capital Flows

From U.S. Banks to Residents of Non-Oil Exporting Developing Countries

(Credits and Deposits $ Millions)

(+ Inflow to LDC)

	1971	1973	1974
Brazil	+218	+73	+498
Egypt	−10	+19	+6
Zaire	+30	−23	+46
India	+258	−4	−188
Korea	+198	+115	+363
Philippines	−85	−46	−75
Thailand	+444	+7	+83
Other Non-Oil	+511	−533	+2,195
TOTAL	+1,564	−392	+2,928

Source: Treasury Bulletin

The new joint IMF/IBRD Development Committee will be examining ways in which less-developed country access to private capital markets might be increased. One suggestion under examination is to seek ways to overcome the impediments posed by lack of knowledge and experience with developing country security issues. One way to do this might be a guarantee mechanism whereby the donor countries collectively or individually would, during a transitional period, guarantee payment of interest and principal to bondholders in case of default. Another would be to provide technical advice in use of capital markets. Steps could also be taken to reduce or remove legal impediments to the use of capital markets which now exist in both creditor and debtor countries.

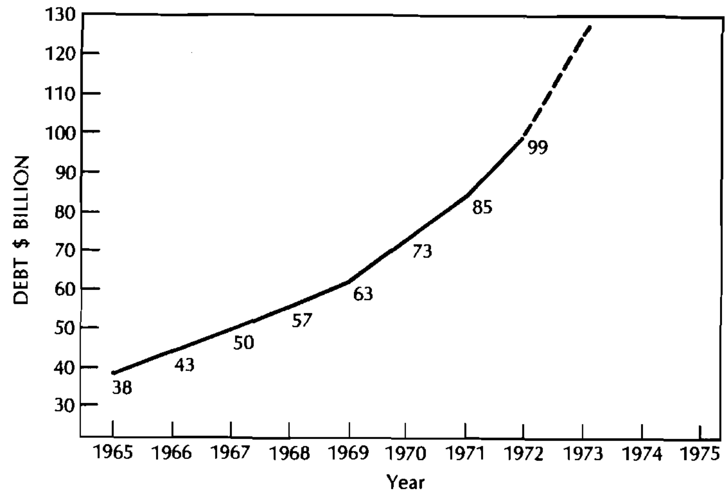
E. *Debt: Burdens, Service and Rescheduling*

The Administration submitted to the Congress on February 28, 1975, a comprehensive report on the debt situation in developing countries. The total external debt (disbursed) of developing countries was estimated by the World Bank to be $117 billion at the end of 1973. (This probably increased substantially in 1974.) One half is concentrated in ten countries (India, Brazil, Pakistan, Mexico, Indonesia, Iran, Argentina, South Korea, Yugoslavia, and Turkey). The poorest countries, those with per capita income less than $200 per year, accounted for less than 25 percent of the total. Borrowing contracted on commercial terms has increased rapidly, particularly in the relatively high income less-developed countries, and now accounts for over one-half of the debt outstanding and about three-quarters of the debt service. A significant portion of this debt may have been utilized to finance essential current consumption rather than investment in 1974; however, this is difficult to determine.

Total service payments due from foreign debt of the less-developed countries exceeded $15 billion in 1973.

Figure 21

External Public Debt of 86 Developing Nations



Debt and debt service grew in the period 1965-72 at 14-15% annually. At the end of 1972 one-half of the external debt of developing countries was concentrated in nine countries: India, Brazil, Iran, Indonesia, Mexico, Pakistan, Israel, Korea and Argentina. Total debt tends to be concentrated in relatively better off countries. Countries with *per capita* incomes below $200 accounted for 51% of total population of developing countries but for only 23% of the total debt in 1972.

Source: IBRD, Annual Report

The large majority of debtor countries has successfully managed to avoid serious debt servicing difficulties. Since 1956, there have been approximately 35 international agreements arranging debt reschedulings for 13 countries. (Repetitive agreements with the same country often are deliberately undertaken to provide a means of reviewing the debtor country's progress).

Figure 22

International Debt Rescheduling 1959-1974

Year	Country	Total Amount Rescheduled ($ million)	Amount of U.S. Debt Rescheduled ($ million)	Consolidated Period
1956	Argentina	500	0	Arrears to 6/30/56
1959	Turkey	400	0	5 yrs., 5 months
1961	Brazil	300	0	4 yrs., 7 months
1962	Argentina	240	0	2 years
1964	Brazil	200	44.5	2 years
1965	Chile	96	43	2 years
1965	Turkey	220	15	3 years
1965	Argentina	76	18	1 year
1966	Ghana	170	.511	2 yrs., 7 months
1966	Indonesia	247	51	1½ years
1967	Indonesia	95	23	1 year
1968	India	300	27	3 years
1968	Peru	58	0	1½ years
1968	Indonesia	85	22	1 year
1968	Ghana	100	.141	3½ years
1969	Peru	70	0	2 years
1970	Indonesia	2100	215	All Maturities
1970	Ghana	25	0	2 years
1971	India	92	9	1 year
1971	Yugoslavia*	59	59	2 years
1971	Egypt*	145	145	4.5 years
1972	Cambodia	2	0	1 year
1972	Chile	160	65	1 yr., 2 months
1972	Pakistan	234	51	2 yrs., 2 months
1972	India	153	29	1 year
1972	Cambodia	2.5	0	1 year
1973	Poland*	32	32	2 years
1973	Pakistan	103	23	1 year
1973	India	187	29	1 year
1974	Ghana	290	0	pre-1966 commercial
1974	Chile	367	136	2 years
1974	Pakistan	650	211	4 years
1974	India	194	45	1 year

*Bilateral

Source: State Department

The adjustment of the world economy to increased oil prices which dominates the global economic outlook is likely to have a major impact on the external financing requirements of many less-developed countries. The capacity of individual countries to respond to current problems varies widely. For many of the oil-importing less-developed countries, some of whom already had precarious developmental prospects, the rise in petroleum and other import prices intensifies current balance of payments problems and their ability to service debt. At the same time, world inflation has served to reduce the real burden of payments on older debt in those countries whose export income has increased as a result of price rises. (A recent World Bank study indicates that the real burden of debt contracted five years ago has decreased by about one-third.)

Many developing countries are now adding to their medium term debt in order to finance adjustment to the changing economic relationships. Should this continue for an extended period, debt service problems may develop in the medium term. The poorer countries most affected by recent economic events cannot resort to additional borrowing at commercial terms to offset the higher prices of oil and other imports: neither their credit standing nor their debt servicing capacity would allow it. For these countries additional concessional capital is required if they are to avoid substantial reduction in living standards and interruption in their economic development.

The fact that developing nations are struggling to sustain growth momentum has reinforced a view among them that debt problems should be viewed within the context of their development objectives. Many of the relatively poorer countries, primarily those still heavily dependent on concessional assistance, argue that debt relief is one means of increasing total external resource flows.

Figure 23

Debt Service in 1975 on Government Lending Due to DAC Member Countries from Selected Developing Countries

Country	Interest payments $m (1)	Amortization payments $m (2)	Total debt service $m (3)	Debt service as % of: Development Assistance Receipts (4)	GNP (5)
Cameroon	3.5	9.3	12.8	29	1.10
Kenya	7.3	9.4	16.7	26	0.90
Mali	0.5	3.1	3.5	17	0.95
Mauritania	0.4	1.9	2.2	29	1.10
Niger	1.6	3.2	4.9	18	1.23
Tanzania	3.6	5.0	8.5	19	0.58
Bangladesh	2.5	0.8	3.3	6	0.06
India	151.0	304.5	455.7	58	0.73
Pakistan	65.6	100.1	165.5	47	2.00
Sri Lanka	5.8	14.9	20.7	41	1.64
Ghana	5.3	5.0	10.3	18	0.46
Ivory Coast	6.8	16.5	23.4	48	1.35
Total	253.9	468.7	719.0		

Source: DAC

The relatively high income developing nations, more trade oriented and conscious of the importance of maintaining creditworthiness, perceive that their long-run interests are best served by concentrating both on insuring adequate availabilities of external finance for the future and on strengthening their capacity to service debt. Thus, they tend to view the current situation as one which demonstrates the need for improving their access to international capital markets and expanding their trading opportunities.

The developed countries emphasize the importance of debtor country economic policies as the most effective means of avoiding debt problems. In deciding whether debt relief is appropriate, creditors prefer to examine each case on its merits. Given the variety of debt problems for countries in different economic situations, the developed countries do not believe it is possible to develop universal criteria on eligibility for debt relief. Creditor countries, including the U.S., distinguish between their policies covering aid and debt relief, even though debt relief negotiations take the debtor's long-term development into account. The international development lending institutions oppose rescheduling their own credits primarily to avoid jeopardizing their own credit ratings.

As the largest creditor of developing countries, the U.S. is well aware of potential debt service problems. The United States does not, however, choose to utilize debt rescheduling as an instrument for the provision of economic assistance. The U.S. has participated in programs of international institutions concerned with debt service problems of developing countries. Developing countries have a good record in meeting service payment obligations to the U.S. In 1974 the U.S. participated in three multilateral reschedulings: Pakistan, India, and Chile; however reschedulings shall remain limited to exceptional cases determined on an *ad hoc* basis.

F. *Implications of Development Assistance for the United States Economy*

Total flows of American official development assistance currently amount to less than one-quarter of one percent of the U.S. gross national product. In assessing the real costs of aid to the American economy, the value of alternative uses (opportunity costs) of this assistance must be considered. These costs differ depending upon the level of activity in the economy, the sectors of the economy effected, relative prices, and the nature of the alternative use i.e., whether it would have been invested or consumed. In a period of slack, such as the present, domestic expenditures for aid purposes can increase demand and have a marginal stimulative and multiplier effect on the economy. Concurrently these expenditures can have a stimulative effect on demand for exports resulting from the possible multiplier effects upon the economy of the aid recipient. Given the size of our foreign assistance programs, their impacts on the domestic economy are small.

G. *Procurement in the U.S.*

The effect of foreign aid on the U.S. balance of payments is small. Its negative effect, at worst, is very much smaller than the aggregate assistance expenditure; much of the expenditure is made in the U.S. The procurement of commodities funded by U.S. bilateral capital assistance loans is basically restricted to purchases either from the U.S. or a developing country source. The exception for developing economies is intended to provide an incentive to production and exports in those economies. The impact of procurement from developing country sources has, however, been limited. From December 1969 to March 1974 only $75 million in loan procurement funds were used to procure from less-developed sources; of this $47 million represented transactions in calendar year 1973.

Because of the critical need for fertilizer in the developing world, coupled with the current shortage of supply in the U.S., special provisions have been made to allow for procurement of fertilizer from developed country sources in compliance with the Congressional mandate.

Procurement from other developing nations, which has been permitted for several years under the U.S. program, has now been generalized to other aid donors. As a result of discussions within the Development Assistance Committee of the OECD, a Memorandum of Understanding was developed in which major members of the DAC agreed to participate in the untying of bilateral development loans in favor of procurement in the developing countries.

The procurement in the U.S. under AID's concessional lending program helps in the export of a variety of U.S. goods and services. For FY 1974, out of total expenditures for development assistance of $1,268 million, $908 million is estimated to have been spent in the U.S. Total expenditures for supporting and reconstruction assistance in Indochina, Jordan, and elsewhere were $622 million, of which $446 million is estimated to have been for procurement in the U.S.

$536 million was expended offshore for commodities in less-developed countries, local currency activities, training programs, supporting assistance cash grants, and disaster relief. Offsetting these offshore expenditures were receipts of interest and principal on previous loans of $405 million. Taking account of the $5 million in expenditures in excess currencies, the net impact of AID activities in FY 1974 was a net outflow of $126 million. But this may be overstated since the effect upon U.S. exports may extend over several years after the aid expenditure is made.

Multilateral aid also has a positive impact upon the domestic U.S. production. The U.S. Government seeks to ensure that U.S. suppliers receive equality of access to procurement financed by the various international finance and development organizations. The Government also makes an effort to ensure that U.S. businessmen receive timely and useful information on trade opportunities generated by development lending activities, permitting them to decide whether they wish to compete for this business.

As reported to the Congress by the National Advisory Council in its annual reports, the trends in the shares of goods and services supplied by U.S. business under projects financed by the international development lending institutions has been uneven in recent years. The percentage of Asian Development Bank (ADB) ordinary capital contract awards gained by U.S. suppliers rose from 6.9 percent in calendar year 1972 to 15.4 percent in calendar year 1973. Should this trend continue, the 10.4 percent cumulative U.S. share of procurement from ADB ordinary capital would improve.

Until April 19, 1974, U.S. suppliers were not fully eligible for contracts financed by ADB Special Funds (now referred to as the Asian Development Fund). At that time the $50 million U.S. contribution to the ADB Special Funds was deposited. U.S. suppliers were notified of their eligibility to participate in the ADB Special Funds because of this contribution. A notable improvement in procurement procedures is that the ADB now generally requires an interval of at least 60 days between the issue of invitation and the deadlines for submitting bids and technical proposals. This policy of a 60-day interval, which was requested by the U.S. Director, provides prospective U.S. bidders with additional time in which to formulate and submit bids. Thus, because of these two new factors and increased efforts to alert U.S. suppliers concerning procurement at the ADB, there is reason to believe that the U.S. share of ADB procurement will improve.

The U.S. share of external procurement under IBRD/IDA projects declined from 18.0 percent in fiscal year

1973 to 16.5 percent in fiscal year 1974. The National Advisory Council undertakes periodic reviews of the World Bank's procurement guidelines. World Bank procurement also has been the subject of a report (B-161470) presented by the Comptroller General of the United States to Congress. This report assigned the major reason for the low U.S. share to a deterioration of U.S. competitiveness, to the Bank emphasis on international competitive bidding, and to the geographical distribution of World Bank loans. The report expressed some hope that dollar devaluations and attendant currency realignments would increase the U.S. share by making it possible for U.S. suppliers to be more competitive in World Bank procurement. Also, the Department of Commerce adopted an early warning system several years ago designed to notify U.S. businessmen of forthcoming procurement opportunities from Bank projects. Systematic procedures were instituted involving coordination between the Department's field offices, suppliers, and State Department officers abroad. These are designed to ensure that U.S. businessmen are able to receive timely and useful information on bidding opportunities. Hopefully this will improve the U.S. share of World Bank procurement.

U.S. suppliers have customarily enjoyed a large percentage of procurement by the Inter-American Development Bank. This reflects the fact that Latin America has historically been a major market for U.S. goods and services. The percentage of foreign exchange procurement won by U.S. business firms under IDB projects dipped slightly from 49.5 percent in calendar year 1972 to 47.4 percent in calendar year 1973. Calendar year 1974 results are not yet available.

The overall effect of all U.S. transactions with the international development finance institutions on the U.S. balance of payments is favorable on the official reserve transactions basis. All purchases in the United States financed by these institutions in addition to investments placed with American institutions, plus interest payments to Americans, plus administrative expenses of those organizations located in this country, resulted in an aggregate positive balance in excess of $2 billion through 1971. The following table is illustrative.

Figure 24

Estimated Effect of Development Finance Institutions On the U.S. Balance of Payments

($ millions)	Aggregate from Period of Inception to 1971				
	IBRD	IDA	IDB	ADB	GRAND TOTAL
Gross transfers to the Development Institutions[1]	3,718	655	1,420	131	5,924
Gross receipts by the U.S.	4,968	386	966	10	6,330
Net U.S. Receipts	1,250	—269	—454	—121	406
Long term Investments in the U.S.	1,580	—	329[2]	61	1,970
Net U.S. Receipts and Long-term Investments	2,830	—269	—125	—60	2,376

[1] Official payments, commercial credits, etc.
[2] Short-term

SOURCE: U.S. Congress, Committee on Foreign Affairs

VI

Agriculture and Food Assistance

Over the past few years rising food prices at home and abroad, and reports of malnutrition and starvation in some less-developed countries, have focused world attention on food. Sparked initially by crop failures caused by adverse weather conditions and added demand for food as a result of rising incomes, the world food problem was compounded by increased prices for fertilizer, petroleum, and other agricultural inputs. The most serious shortages, and resulting malnutrition, occurred in the developing countries where rapid population growth requires annual increments in either food production or imports, but the effects were also felt in the developed countries. In the United States, prices increased sharply for food and feed grains, and livestock herds were significantly reduced. As a result, domestic economic policy considerations impinged directly on international food policy, and opinions differed widely on the severity of the problem and appropriate solutions.

The World Food Conference, held in Rome November 5-16, 1974, under the sponsorship of the UN, represented an international attempt to come to grips with the problem and coordinate future efforts. In preparation for the Conference, the Secretariat drawn from the UN Food and Agriculture Organization (FAO) issued an *Assessment of the World Food Situation: Present and Future*, and the U.S. Department of Agriculture (USDA) compiled its own assessment which was published after the Conference as *The World Food Situation and Prospects to 1985*. The conclusions of the two studies agree in essence on the causes of recent food scarcities and the outlook for the future: "The phenomenon of high food prices and uncertain supplies (which occurred from 1972-74) arose out of a combination of circumstances, policy changes, and long-term development trends, which raise very important issues but which do not indicate a long-run shortage of food." (USDA)

During the late 1960s and early 1970s grain and fertilizer prices were relatively low. Food exporting developed countries restricted grain production in order to reduce surplus stocks, and overcapacity in the fertilizer industry reduced fertilizer prices. In 1972, world food output declined for the first time in 20 years as a result of bad weather in the USSR, China, India, Australia, Sahelian Africa, and South-East Asia. The USSR imported large amounts of grain in 1972/73, in order to continue its expansion of livestock production, and the less-developed countries increased their food imports in 1973/74. These purchases depleted the stocks of the United States, which had held the major portion of world reserves. Faced with tight supplies and soaring prices, we reduced our food aid shipments to developing countries.

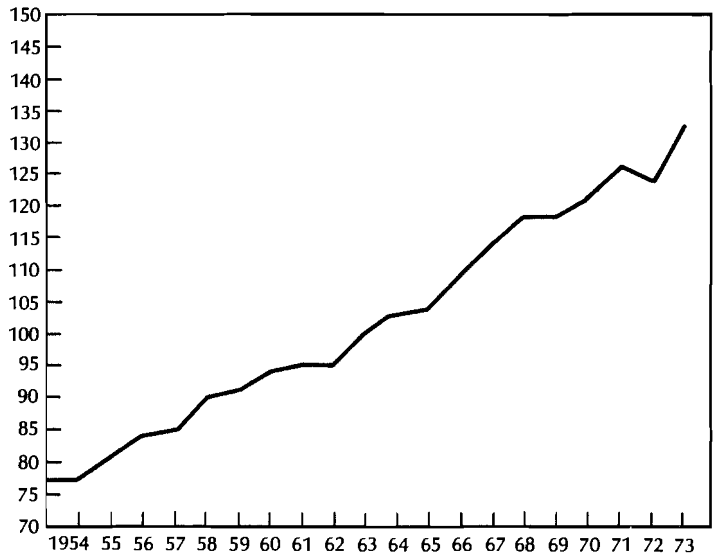
Figure 25

Food and Fertilizer Prices, 1967-74
(1967 = 100)

	Wheat (US)	Rice (US)	Urea (Europe)	Diammonium phosphate (US)
1967	100	100	100	100
1968	89	101	81	88
1969	90	100	71	85
1970	96	104	61	79
1971	96	107	58	91
1972	127	135	75	134
1973	285	277	120	175
1974 (est.)	311	217	380	440

Sources: *Agricultural Prices*, Statistical Reporting Service, USDA;
(wheat and rice are on crop year basis)
IBRD, AID

Figure 26
Index of World Food Production (1963 = 100)



Source: Economic Research Service, USDA

Figure 27

World Wheat and Coarse Grains Beginning Stocks (1,000 Metric Tons)

Year	World	Major Exporter [1]	U.S.
1960/61	169,106	127,838	103,683
1961/62	182,052	138,776	115,834
1962/63	155,410	115,912	101,654
1963/64	158,687	110,286	91,144
1964/65	153,820	108,790	87,586
1965/66	156,990	94,710	72,250
1966/67	121,242	69,875	53,243
1967/68	150,338	69,324	45,776
1968/69	162,336	84,446	59,097
1969/70	190,775	106,971	68,192
1970/71	167,993	112,745	68,714
1971/72	130,608	82,923	50,593
1972/73	148,796	94,534	68,516
1973/74	108,493	59,933	42,128
1974/75	110,452	47,435	27,110
1975/76	89,522	32,122	18,472

Source: USDA Grain Data Base, April, 1975

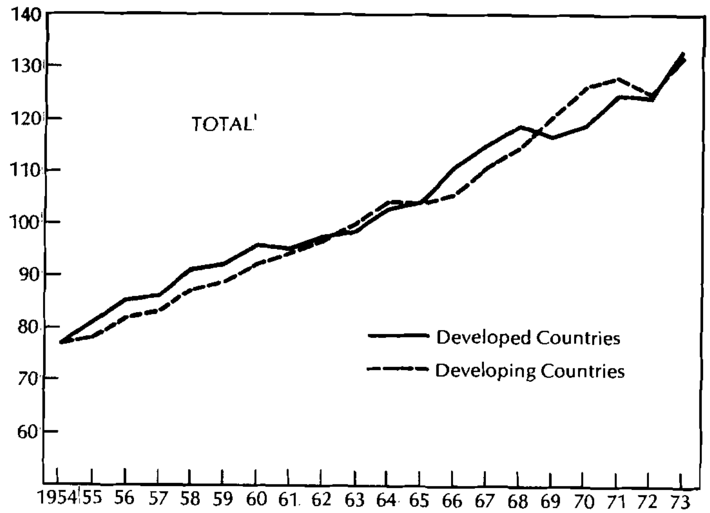
[1] U.S., Canada, Australia, Argentina

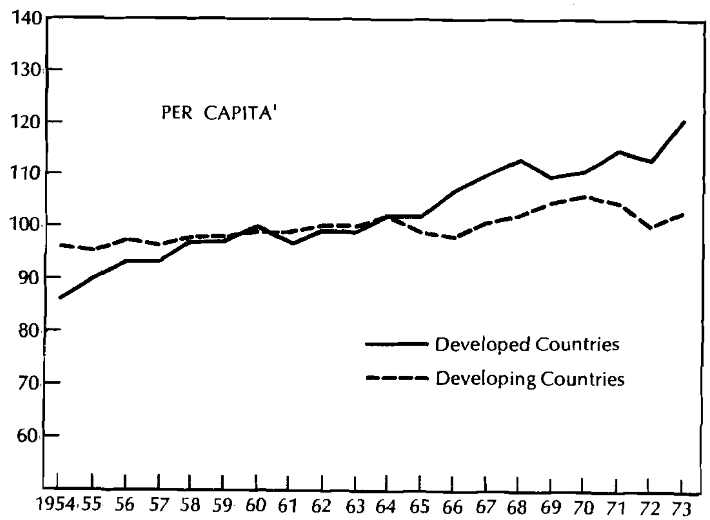
Non-agricultural factors have also influenced the price and supply of food. Rising affluence in the developed countries has increased demand, particularly for livestock which consume large quantities of grain. Higher prices for fertilizer, brought about by full utilization of existing world productive capacity, have been exacerbated by the rising prices of petroleum and other raw materials. The latter price increases have also affected the costs of irrigation, transport, pesticides and other components of food production, marketing, and distribution.

The removal of U.S. acreage limitations in 1973, and higher grain prices, resulted in increased U.S. food production in 1973, but production in 1974 was below expectations. Although current predictions for 1975 are good, at best this crop will permit only partial rebuilding of stocks. Depletion of stocks means that the world is now dependent on annual food production to offset annual increases in demand.

During the 1950s and 1960s the less-developed countries as a group expanded their agricultural output as fast as the developed countries. However, due to more rapid population growth, greater increase in demand (3.5 percent per annum in the developing countries as compared to 2.5 percent per annum in the developed countries) caused the less-developed countries as a whole to increase their imports.

Figure 28
Index of World Food Production[1]
(1961-1965 = 100)





[1] Excluding Communist Asia

Source: World Food Situation and Prospects, Economic Research Service, USDA, 1974

Although population growth and unfavorable weather were the prime factors, the increasing dependence of less-developed countries on food imports probably was also a result in part of cheap grain imports at concessional terms in the late 1950s and 1960s made possible by surplus stocks in the United States and other exporting countries. Reliance on these imports sometimes led to developing country policies which failed to encourage maximum local food production.

The accumulation of food stocks in the United States was the result of programs designed to support domestic farm incomes. The cost of carrying these stocks was borne by the taxpayer, and high price supports also resulted in increased prices for the consumer. Since the Administration wishes to move toward a free market and is reluctant to resume the agricultural policies which formerly helped generate large surpluses, some other provision will have to be made to ensure the availability of food for assistance to poor, deficit countries.

The USDA report rejects the Malthusian conclusion that we have nearly reached the limit of the world's ability to feed even the present population and must therefore reconcile ourselves to a *triage* policy of assisting only those with the best chance of survival. USDA further rejects the more moderate view that we have entered a period of more or less chronic scarcity and higher food prices caused by population growth and rising affluence. Rather, USDA concludes that "the availability of inputs—the underlying major determinant of the world's ability to produce more food—does not appear to be an impediment to future increases in production."

At the same time, the USDA does not minimize the magnitude of the task ahead which will require serious reevaluation of agricultural, food, and trade policies in many parts of the world. Clearly, a greater effort will have to be made to increase food production in the developing countries. However, the USDA warns against a simplistic notion that self sufficiency should be the goal everywhere. If we assume that the proper objective is the provision of an adequate food supply at the most economic cost, the problem becomes one of organizing world food production, trade, and aid in the most efficient manner possible to meet this goal. The United States with its rich technical, human, and natural resources for food production, will need to play a fundamental role in the search for a solution.

If less-developed countries are to provide their growing populations with nutritious diets, they will need to choose one or, more likely, a combination of the following approaches:

1. increase food production;
2. increase food imports on commercial terms (financed essentially by increased exports);
3. obtain food aid; or
4. seek other assistance from either developed or newly rich developing countries (such as oil exporters) with which to finance food imports.

In all of the above cases, the United States is likely to be involved—either as the provider of technical assistance and other inputs in support of less-developed country production, as an importer of less-developed country exported goods, or as an exporter of food commodities. We need not, however, be the sole providers of financing, even for purchases of the food we grow. The choices made by the less-developed countries and ourselves will have differing domestic consequences in the United States, and they will also have a profound influence on the living standards of the majority of the population of the less-developed countries.

A. *Less-Developed Country Food Production*

In the Foreign Assistance Act of 1973 the U.S. Congress explicitly directed AID to increase its assistance for food production, rural development, and nutrition, and to concentrate on improving the lives of the majority in the rural areas. This instruction reenforced AID's own policies and has led to an increase in funds programmed for food production and nutrition from $192 million in FY 1972 to a proposed $653 million in FY 1976. In FY 1975, Congress failed to provide the funds it had authorized and appropriated only $300 million (sufficient for a program level of $476 million) compared to an Administration request for an appropriation of $546 million. The World Bank, to which the United States is the leading contributor, increased its support for agriculture from $436 million in FY 1972 to $938 million in FY 1973 and $956 million in FY 1974. While some of these increases will simply cover the cost of increased prices of fertilizer and other agricultural production inputs, the program increases do reflect a renewed emphasis.

The factors contributing to increased food production are numerous and differ from country to country. The increased yields associated with the Green Revolution depend upon the use of nitrogenous and phosphatic fertilizers, as well as improved seed varieties and irrigation.

AID fertilizer financing for development programs in FY 1975 is estimated at about $225 million. Since U.S. fertilizer supplies became tight in 1973, AID has restricted funding of U.S. fertilizer, but has financed fertilizer procured abroad. Various measures are being considered to relieve future shortages. These range from efforts to increase fertilizer production throughout the world to suggestions that fertilizer consumption for non-food purposes be reduced. For those developing countries with natural gas—such as Pakistan and Bangladesh—or phosphate rock, fertilizer production is practical, and AID may participate in construction of one or more plants. The Agency is also providing technical assistance through the Tennessee Valley Authority to raise the efficiency of existing fertilizer capacity.

Even where all the inputs are available, considerable research is needed to develop and adapt technology to local conditions. For this reason, AID increased funds for agricultural research by over 100 percent from FY 1971 to FY 1975, when they are expected to be over $40 million. Further expansion is planned. The research funds are used both to strengthen less-developed country national agricultural research systems and to support the network of regional research centers coordinated by the Consultive Group on International Agricultural Research.

Irrigation is a critical component of the Green Revolution. Efficient water management, however, goes beyond the construction of irrigation canals. It involves attention to problems of land leveling, salinity control, and distribution and utilization of irrigation water. To reduce waste from spoilage and rodents, storage facilities need to be improved. The technical knowledge for dealing with these problems exists, and AID is providing technicians to apply it in individual countries, but maximum application requires host government commitments of money and incentives through the adjustment of policies on price, land ownership, marketing, and credit.

There is growing evidence that both on equity grounds and in order to increase food production in the long run, greater efforts should be made to involve the small farmer in the food production process. The AID program, with strong endorsement from Congress, is expressly directed toward small farmers. This is done through specific technical assistance programs in rural development and, perhaps more importantly, by weighing all other AID projects in terms of their impact on rural incomes and selecting for funding only those which seem to offer most for the small farmer.

Although AID technical and financial assistance may be helpful in stimulating increased food production, developing country policies will be the determining factor. Many less-developed country governments choose to maintain artificially low food prices for urban dwellers. To do so, they must use the government budget either to subsidize the consumer or the price paid by farmers for fertilizer and other inputs, or pay a stiffer price in the form of low production resulting from insufficient incentives to farmers. Low prices to farmers deter them from making maximum use of fertilizer and other expensive inputs and frequently prompt them to smuggle part of the crop out of the country or to a domestic black market. To cover the national shortfall, the government is then forced to purchase food from abroad, often paying foreigners in scarce foreign exchange a price it would not pay its own farmers. While this practice may have been possible in the days of plentiful concessional food and low world market prices, it is an expensive procedure today, draining scarce foreign exchange which might otherwise be available for development purposes.

Both the Foreign Assistance Act and PL 480 are replete with references to self-help measures required on the part of the recipient governments. However necessary such measures may be, if the recipient government is not inclined to carry them out, there are limits to the influence U.S. Government officials can exert. Other aid donors face the same problem. Thus foreign aid donors often find themselves in the difficult position of deciding whether or not to approve a given project likely to increase food production and raise small farmer incomes, even though they feel that certain changes in government policy needed to improve the chances of success for the project and overall agricultural development are unlikely to be made. The choice is not an easy one, and has to be made on a case-by-case basis.

For those developing countries whose development plans are predicated on food imports financed through export earnings, continuity of access to supplies of food is essential. As the world's largest food exporter, our export policy will have a direct effect on the availability of supplies during times of shortage. During the last quarter of 1974, the U.S. Government instituted a system of voluntary reporting and prior approval of all grain and certain other commodity sales over a certain magnitude. Although this monitoring procedure was administered with due regard for the special needs of the food deficit developing nations, the mere existence of the system increased the uncertainty for planners in such countries. With the loosening of supplies in 1975, the system was eliminated on March 6, 1975. The only remaining requirement is that of the Agriculture and Consumer Protection Act of 1973 for after-the-fact reporting of sales. Although temporarily of less urgency than some issues, the question of export controls will be given consideration in coming multilateral discussions of food, trade, and commodities, and will be of concern to the Development Coordination Committee.

In a time of scarcity, little is said about the impact of increased less-developed country food production on U.S. markets. Nevertheless, this is a subject which has received attention in the past. Expanded less-developed country food production will influence the demand for U.S. food exports. In general, the United States has viewed efforts to improve developing country production as consistent with its objective of increasing U.S. exports of both manufactured and agricultural products. This attitude is supported by evidence that increased less-developed country incomes from growth of manufacturing and agriculture create increased demand for imports, including imports of U.S. agricultural products.

The U.S. Government's policy guidance, which has been in operation almost a decade, dealing with the question of assistance to agricultural development explicitly gives priority support to developing country efforts to meet their own food needs. It further recognizes that some crops must be exported by these countries; however, it adds that "due consideration" should be given to continued expansion of markets for U.S. agricultural commodities or products thereof. The implementation of this policy may occasionally encounter apparent contradictions, but not often.

B. *Food Aid*

Since 1954 the United States has provided over $20 billion worth of food and nonfood agricultural products under the Agricultural Trade Development and Assistance Act (PL 480) on a grant or concessional dollar and local currency sales basis. Originally intended as a temporary measure to be discontinued when U.S. surplus agricultural commodities diminished, its ultimate objective was seen as the development of commercial markets to replace food donations and credit sales.

PL 480 was extensively revised in 1966 to reflect declining U.S. food surpluses and to emphasize the importance of food aid as a means to combat malnutrition and promote agricultural self-help and voluntary family planning activities in developing countries. At that time, the requirement that agricultural commodities be in a "surplus" market situation before they could be eligible for sales or donation was removed from the law. However, the legislation retained the requirement that no commodity be made available for PL 480 use if the disposition would reduce the domestic supply below the level needed to meet domestic requirements, adequate carryover, and anticipated commercial exports. Since December 1971, all new concessional sales have been repayable in dollars or convertible local currency rather than in non-convertible local currency as was previously permitted.

The Act, as amended in 1966, has been extended essentially unchanged through December 31, 1977, but the Foreign Assistance Act of 1973 did contain an amendment expressing the sense of the Congress that legislation providing increased flexibility for responding to emergency and humanitarian requirements for assistance should be considered. A bill containing such a provision was introduced in Congress in December 1973 and reintroduced with Administration support in February 1975 but has not yet been enacted. Such legislation would permit the Secretary of Agriculture to determine that a part of the exportable supply should be used to carry out PL 480 objectives.

The value of PL 480 shipments has averaged about $1 billion annually, ranging from a high of $1.6 billion in calendar year 1964 to a low of $750 million in 1973. U.S. agricultural commodities provided as concessional sales represented 26 percent of total agricultural exports in 1962 and 1963 but declined steadily to 12 percent in 1972 and dropped sharply to 4 percent in 1973 and 3 percent in 1974.

Figure 29

PL 480 Shipments Compared with Total U.S. Agricultural Exports
1954-1974
(Calendar Years $ Millions)

	Total PL 480[1]	Total Agricultural Exports	PL 480 As a % Of Total
1954 July-December	48	1,585	3
1955	505	3,199	16
1956	890	4,170	21
1957	974	4,506	22
1958	954	3,855	25
1959	875	3,955	22
1960	1,187	4,382	25
1961	1,123	5,024	22
1962	1,307	5,034	26
1963	1,472	5,584	26
1964	1,578	6,348	25
1965	1,304	6,229	21
1966	1,265	6,881	18
1967	1,217	6,380	19
1968	1,175	6,228	19
1969	1,021	5,936	17
1970	1,021	7,259	14
1971	932	7,693	13
1972	1,107	9,401	12
1973	750	17,680	4
1974 (preliminary)	760	21,994	3

[1] Excludes PL 480 barter transactions since they are primarily commercial in character.

Source: USDA

Because of short supplies, the quantity of commodities shipped in FY 1974 was less than half that shipped in FY 1973. Nevertheless, because of higher prices, even in 1974 food aid was roughly equivalent to three-fourths the dollar value of AID development assistance and in FY 1975 it is expected to exceed AID development assistance. While the amount of food which will actually be shipped in FY 1975 is not yet known, the final approved program level is $1,470 million for the purchase of commodities and $147 million for shipping-funds sufficient to provide 5.5 million tons of grain and grain products at the time the program was approved in February 1975.

Funds for the PL 480 program are appropriated to the Department of Agriculture, and the Secretary of Agriculture is responsible for determining commodity availabilities. Country program allocations are approved by the Inter-Agency Staff Committee (ISC) on PL 480 which is chaired by the Department of Agriculture and includes State/AID, Treasury, Defense, Commerce and the Office of Management and Budget. Food scarcities and high prices in recent years have heightened the importance of these decisions, and major policy choices have been referred to the President. In making these decisions, careful attention has been paid to the impact of quantities and timing of purchases for food aid on U.S. domestic food prices.

Under Title II, which has historically constituted about 30 percent of the PL 480 program, agricultural commodities are donated to meet famine and other relief requirements, and for humanitarian purposes directed particularly at malnourished children and mothers. These programs are administered on a bilateral government-to government basis, through American and international voluntary organizations, and in support of programs of the World Food Program of the United Nations. The U.S. Government also pays the cost of shipping the donated commodities under this Title. In recent years, the American voluntary agencies, such as CARE and Catholic Relief Services, which administer the major portion of Title II food donations, have expressed concern about the effect of U.S. Government reductions in supply and uneven approval of food levels on their ability to carry out effective programs in the field. While the voluntary agencies recognize, and are grateful for, the Administration's efforts to continue Title II programs at or near planned levels during the recent period of commodity shortages, they feel that the problem might be corrected through multi-year programming of Title II food donations. The Development Coordination Committee hopes to examine this issue during the coming year.

Much of the debate on the PL 480 program in recent months has been centered on the distribution of the Title I commodities which are sold on concessional terms similar to AID development loans. For a country which would need to import food in any event, the provision of food on PL 480 terms is the equivalent of a concessional capital transfer which helps its balance of payments. The Congress has argued that this food aid should go primarily to the most needy countries rather than to countries in which we have a strong political or security interest. This criticism was incorporated in the amendment to the Foreign Assistance Act of 1974 which requires the Administration to allocate no more than 30 percent of Title I food aid for countries not on the UN's list of countries most seriously affected by the current economic crisis.

A recurrent difficulty of the PL 480 program is its dependence on availability of supplies and the late timing of decisions on program size. This problem was accentuated in the first half of FY 1975 when, because of the short and indefinite supply picture in the United States, the program was approved on a quarterly basis. The final FY 1975 program level was announced in early February, but there was some doubt as to whether the entire amount could actually be shipped before the end of the fiscal year. Such delays and uncertainties severely disrupt import planning by the recipient countries and undercut U.S. efforts to relate food and programs to food production assistance. This, too, is an issue which the Development Coordination Committee hopes to address in 1975.

There is a sentiment within both the legislative and executive branches that changed circumstances and an uncertain future require a comprehensive review of the food aid program. Some feel that PL 480 ought to be replaced with new legislation reflecting the absence of surpluses. While there is general agreement that we ought to provide food in emergency humanitarian situations, there is less agreement about the quantity and the purpose of the remainder of our food aid. In viewing food aid as an alternative or supplement to AID funds, the possible disincentive effect on the recipient country's own agricultural production must be considered. To make sure that food assistance complements, rather than distorts, other development efforts, it must be examined by both ourselves and the recipient countries in the context of development policy. This guiding principle was added to the Foreign Assistance Act in 1973 and is being given increasing attention. At the same time attention must still be given to the impact of any changes in PL 480 on U.S. domestic agriculture. Whether or not the food aid legislation is revised, there is room for our efforts to increase food production in developing countries. In so doing, it may be wise to keep in mind that greater emphasis on self-help requirements for food aid designed to increase less-developed country food production may in the long-run be the most humanitarian course.

C. *Multilateral Cooperation*

The United States accounted for about 90 percent of total world food aid in the last half of the 1960s. Since 1970 the food aid programs of other developed countries have grown substantially, while the value of U.S. assistance has leveled off. Moreover, oil price increases have created, and will continue to create, a massive redistribution of funds, some of which could be used to pay for food for needy countries.

These new developments are reflected in the follow-up machinery established at the World Food Conference. A number of new or modified FAO committees were given the responsibility to improve information and coordination on the world food problem. The activities of the Consultative Group on International Agricultural Research were expanded, and another Consultative Group on Food Production and Investment was established. Operating under the auspices of the UN Development Program, FAO and the World Bank, the latter group is charged with increasing, coordinating, and improving the efficiency of financial and technical assistance—both bilateral and multilateral—to agricultural production in developing countries.

With the backing of a number of the oil producer nations, an International Fund for Agricultural Development (IFAD) was also recommended by the World Food Conference. As approved at the Conference and in the General Assembly, the resolution establishing IFAD specifically states that the Fund will only become operative when the UN Secretary General determines that it holds promise of generating "substantial additional resources for assistance to developing countries." To date, no specific pledges have been received by IFAD.

The United States has also taken the lead, at the World Food Conference and subsequently, in working toward the establishment of an international system of national food reserves. Originally embodied in the FAO Undertaking on World Food Security, and endorsed by the World Food Conference, the idea of security reserves located in both producer and consumer nations has now received fairly wide acceptance.

In the past, our holding of most of the world's food stocks had a useful effect in mitigating price fluctuations. Now that we have liquidated our stocks, discussion is taking place on how to share this burden.

With the prospect of a bumper crop this year in the United States and good harvests elsewhere in the world, there is a real danger that some of the urgency will be taken out of the effort to build up reserves. Other countries may assume that U.S. price support programs will *de facto* result in our carrying large reserves again and obviate the need for them to cooperate. Alternatively, as prices decline, American farmers may plant less, leading to renewed shortages, without reserves to fall back on to help deficit developing nations meet shortfalls. The uncertainties inherent in either of these possibilities underscore the desirability of prompt negotiation of an international system of grain reserves.

The World Food Conference made considerable progress in creating international institutions designed to prevent or alleviate hunger and malnutrition throughout the globe. Although the American press tended to highlight the immediate issue of the amount of U.S. food aid for the current year, most of the participants agree that the longer-range principles and institutional arrangements agreed on in the resolutions at the Conference were more basic and represent impressive achievements. They are further encouraged by the progress of the first few months since the Conference in setting up the machinery to implement the resolutions. Further headway will depend upon the cooperation of all nations.

ORGANIZATIONS WITH RESPONSIBILITY FOR FOLLOW-UP ACTION ON RECOMMENDATIONS BY THE WORLD FOOD CONFERENCE

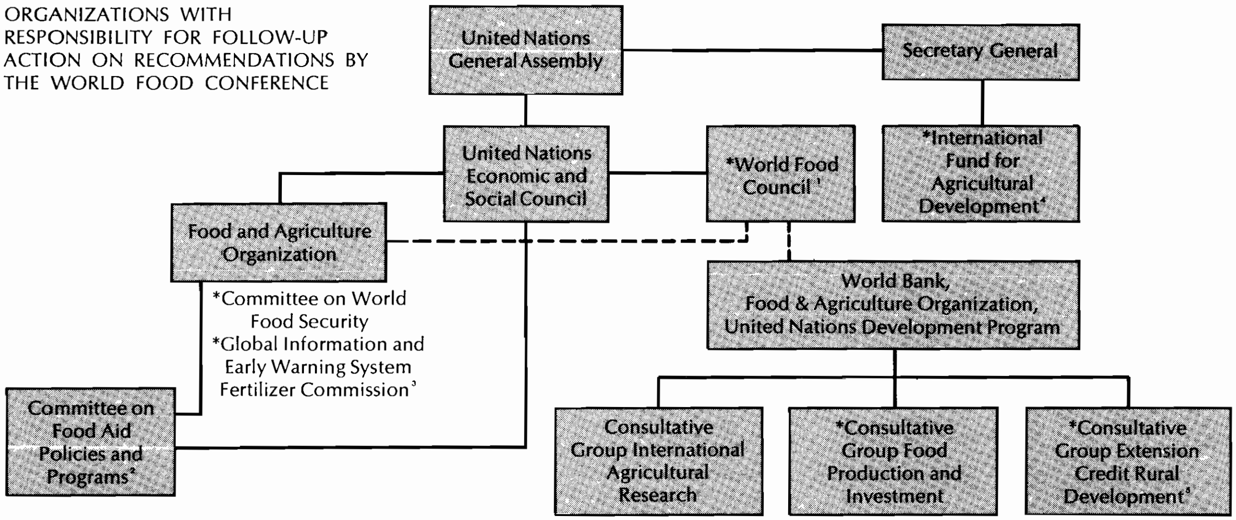


Figure 30

[1] 36 members, nominated by ECOSOC, geographic representation, elected by UNGA, has small Secretariat in FAO Headquarters in Rome, with powers to coordinate, advise and receive reports.
[2] To be formed from the reconstituted Committee of the World Food Program which now reports to ECOSOC and FAO.
[3] Program Strengthened.
[4] Called by United Nations Secretary General; actual establishment will depend on financial commitments not yet received.
[5] An organization with this title, or similar to it, is likely to be recommended in the future.

VII

Population

Population growth practically matched the 3 percent growth in GNP achieved by the developing countries as a whole in 1974. There were variations among countries, but taken as a whole there was no per capita growth last year in the real GNP of developing countries, and the forecast for 1975 is even more bleak. Underlying all other problems developing countries face is the inexorable growth of population.

One-fourth of all people who have ever lived are alive today. The rapid reduction in death rates in the less-developed countries, unmatched by corresponding reductions in birth rates, has created a population explosion. Whereas it took all history to about 1830 to reach a world population of one billion, this year the population will reach four billion; and if present fertility rates are not reduced, by the year 2000 it will reach 7.2 billion. Since population growth rates have been steadily declining in developed countries, the proportion of the world's population living in the developing countries has steadily increased and is now 70 percent. Because of the momentum built into population growth by the low age of the populations of developing countries, even with considerably intensified efforts at fertility control the UN medium projection for the world's population is that it will not stabilize for at least one hundred years, by which time it will have reached 12 billion.

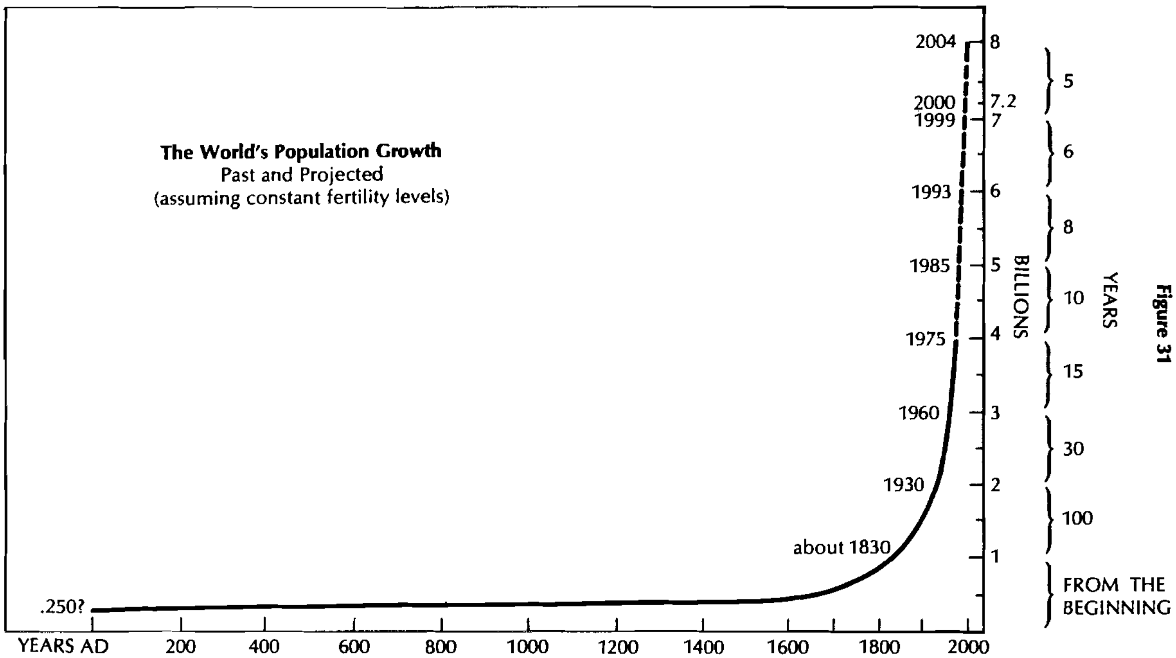


Figure 31

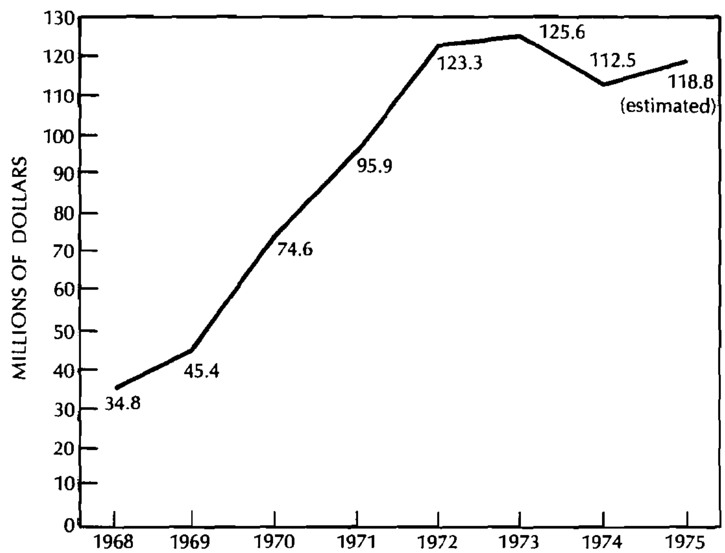
Source: State Dept., The Population Explosion a Present Danger

While it may be possible to grow enough food somewhere on earth to feed all the projected world population, the problems of food distribution and financing suggest that in such a world the number of people dying each year from starvation, or more slowly from malnutrition, will exceed the current annual 10 to 20 million. Similarly, hundreds of millions of children will almost certainly not mature to their full intellectual and physical potential due to inadequate diets. It is impossible to predict the consequences of major crop failures which are likely to occur from time to time. To quote the DAC Chairman's 1974 report: "this may be the last generation that can deal with the population problem through measures compatible with human dignity."

Viewed in historical perspective, the population effort has made considerable progress in only a decade. Whereas in 1963 only four developing countries had national family planning policies and programs, by the beginning of 1973, 34 less-developed countries had such policies and programs, and 21 others were providing some support for family planning activities. Much of the initial effort in arousing governments to action and supporting the establishment of programs was made possible, directly or indirectly, as a result of the U.S. AID program. In its work AID has drawn upon the resources of other U.S. Government agencies, including the U.S. Department of Health, Education and Welfare; and the State Department has played an important role in alerting other governments, both developed and less-developed, to the urgency of the problem.

Figure 32

Funds for AID Population Programs
Fiscal Years 1968-1976



Source: AID

Beginning with a modest program in 1965, AID's funds earmarked by Congress for population increased annually until they reached $125.6 million in FY 1973. In FY 1974 Congress put a ceiling of $112.5 million on the population program, and the ceiling for FY 1975 is $110 million. Almost half AID's funds have been used directly to support country and regional family planning projects in 36 developing countries. The rest has reached more than 70 less-developed countries through contributions to international organizations such as the UN Fund for Population Activities (UNFPA) and the International Planned Parenthood Federation.

Through both governmental and non-governmental efforts, the United States was a pioneer in the international population control field. However, other donors are now involved either on a bilateral basis or by contributing to the UNFPA. Our support played an important role in the establishment of the UNFPA, whose assistance in this sensitive field some countries find preferable to bilateral assistance. To encourage broad participation, in 1970 the United States pledged to match contributions of other donors to UNFPA up to $7.5 million. By 1974 our pledge had reached $20 million at a ratio of 45:55. Other donors contributed $34 million so that our actual percentage was less than 37 percent.

It is hoped that other donors will continue to increase their contributions to the population effort. As they do, the need for coordination and division of labor among programs will become more critical. The U.S. Government can serve this objective by coordinating our bilateral programs more closely with the programs o the UNFPA, the multilateral banks, and the international non-governmental organizations to which we contribute.

A further indication of growing worldwide concern about the problem was the designation of 1974 as World Population Year and the convening, under UN sponsorship, of a World Population Conference in Bucharest in August 1974. Although the final Plan of Action approved by 136 of the 137 nations in attendance fell short of stronger goals advocated by the United States, its passage in even its compromise form represents a considerable achievement, as does the fact that a

Figure 33

The Plan of Action adopted at the Bucharest World Population Conference and approved by the UN General Assembly contained many important propositions of which the following are significant:

—Deciding the number and spacing of one's children is a basic human right.
—Governments should provide individuals the information and means to exercise this right.
—Governments should include population policies and programs in their development planning.
—Quantitative goals and timetables for reducing population growth and mortality are desirable.
—Improving the status of women will help to reduce population growth.
—Reducing population growth and promoting socio-economic development are mutually reinforcing and together lead to a higher quality of life.

conference on so delicate a subject was held at all.

Despite past achievements, about 85 percent of the people of less-developed countries (excluding China) remain without family planning services. To reach this largely rural population, vastly increased resources will be required and ways will have to be found to reduce the cost of the services which are provided. Some developing countries are already distributing contraceptives through shops and other commercial outlets. Use of the private sector for distribution can be expanded. In addition, selected countries may find it economical to manufacture contraceptives. OPIC investment quarantees or assistance could facilitate the participation of American firms in such enterprises.

Many less-developed countries, notably in Africa, argue that family planning services must be provided in conjunction with health services because parents will accept family planning only when their existing children have a decent chance of surviving, because women in traditional societies may feel more comfortable getting family planning services from multi-purpose health establishments, and because it is theoretically cheaper to provide as many services as possible through the same network. Unfortunately, health services have tended to be costly on a per patient basis, often because the focus has been on providing curative services through modern facilities for only a few people rather than providing more elementary services to the rural majority. Joining new family planning programs with inefficient health services seems inadvisable, but may be the only way to make any family planning services available in some areas. AID is helping develop "integrated" systems to provide basic health services, nutrition services, and family planning services as a package to the poor majority at a low per capita cost through the use of paramedics, upgraded traditional practitioners, and other local village personnel.

More research is needed to develop safer, more acceptable and less expensive contraceptive methods. Worldwide expenditures for research on fertility control (of which well over half is in the United States) are well below $100 million—only 10 percent of what the U.S. Government spends on cancer research alone. Equally important is the need to devise more effective means of delivery and communication with the potential recipients.

More needs to be done within the less-developed countries to build population planning into development planning and government budgets. Where we have an AID or PL 480 program, the U.S. Government can help in this process by emphasizing the direct effect of population programs on the success of programs in other fields such as education and health, as well as on the government's ability to feed and provide employment for its people. The complex interrelationship between our food aid and food production assistance and population growth prospects should be explored further. For example, child feeding programs under PL 480 may reduce infant mortality and thus help persuade parents to have fewer children. On the other hand, the continued provision of food on a concessional basis may postpone the recipient government's recognition of the urgency of the population problem. These questions need to be examined at every stage of the development assistance effort.

While acknowledging recent progress in reducing birth rates in some countries, many family planning officials, demographers, donor agencies and governments have come to think that, in addition to the widest possible spread and maximum availability of family planning services and information programs, significant economic and social change will be required to reduce fertility enough to meet development goals. At the outset of the family planning movement, it was widely believed that couples in developing countries wanted fewer children than they were having, and that the provision of safe, effective and convenient family planning services and information would be readily accepted and would suffice to reduce fertility to low target levels. Although the task was seen as enormous, it was considered to be basically one of mobilizing resources and persuading less-developed country leaders to support national programs to provide modern means of contraception to all couples. The results after a decade of effort suggest that although this approach has had some success, the problems are more complex. Data from many countries, particularly in Asia (Korea, Taiwan, Singapore, the Philippines, India, Pakistan) where family planning services have been made available on a wide, though not yet optimal, scale suggest that while desired family size still is less than actual family size, it probably well exceeds the two to three children required if fertility is to fall to the low target levels of these countries.

It has become increasingly evident that existing economic and social conditions motivate couples to have large families. Parents may seek children as a source of labor, and, acting rationally in a country with no social security and high child mortality, they may feel the need to have half a dozen children to be confident one son will survive to support them in their old age. Women, especially the uneducated, whose sole source of status and recognition is a large family, may desire many children. Deep-seated cultural values, as well as legal constraints, may reenforce these considerations.

While they exert a strong influence on family size, these factors are not immutable. Policies that modify these economic and social conditions can persuade parents to seek smaller families. There is already statistical evidence which seems to relate declining birth rates to broad-based development, particularly in the rural areas, including rising literacy rates, female employment outside the home, and improved health conditions. Of particular interest is the fact that when these factors occur, birth rates begin to fall despite the fact that the overall standard of living may still be relatively low.

A number of developing country leaders, including some of the most vocal at Bucharest, now reject specific efforts to control population growth and argue that birth rates will decline naturally in less-developed countries when some "threshold" level of development is reached. The dilemma inherent in this analysis is that in many countries rapid population growth undercuts efforts to develop and will in itself prevent the threshold from being reached.

Those who pose the "development first" argument generally cite the fact that in Europe birth rates came down after development occurred and before the advent of modern contraception. They overlook, however, that in Europe the decline in birth rates took more than one hundred years, during which time populations were growing at only one percent a year (because of high death rates) and those who could not be absorbed in the expanding agriculture and industry could emigrate to the New World.

For a problem as immense and as basic as population much more needs to be known. It is thought that reductions in child mortality will lead to fewer births. Is this true? Under what conditions will what reduction in child mortality lead to what reduction in births? Will increased education for women reduce their child bearing? If so, how much education will lead to what reduction? What is the impact on fertility of employment opportunities for women, and how will programs to increase their employment affect overall unemployment rates? Can small farmers be persuaded to hire landless laborers rather than have children to help on the farm? What kind of social security system or old age protection system, within the means of a developing country, could substitute for the birth of more sons? How do the answers to these and related questions vary country by country and culture by culture?

These are only a few of the questions which need to be investigated. Research on these determinants of population growth and policy measures to influence them is of increasing interest to developing country decision makers. Since it involves allocation of government budgets, and altering social, legal and economic factors, it is a sensitive area in which U.S. assistance must be carefully tailored to respond to the wishes of other governments.

As we explore these underlying factors affecting population growth, we must redouble our efforts to provide information and means to limit family size. Our goal is to expand family planning programs that now reach 5 to 10 percent of the fertile couples of some developing countries to reach all people by 1980, or no later than 1985.

The impact of world population growth on the United States, while imprecise for the immediate future, certainly will influence the kind of world in which our children will live. Food shortages caused by increasing populations elsewhere already have influenced our agricultural policy to enable us to help feed others. Views differ on the extent to which burgeoning populations will foment social unrest, which in turn might threaten U.S. security. However, there is no doubt that population pressures elsewhere are felt in the United States; for example, by migration here from countries facing population pressures on available jobs.

Figure 34

Progress

—current consciousness of population issues
—increase in national family planning programs from 4 countries in 1963 to 34 in 1973
—growth of other donor assistance: from $7 million in 1969 to $52 million in 1973
—World Population Year and Conference, 1974
—success in reducing population growth rate in many countries with national population control programs

Figure 35

The Job Ahead

—need to reach at least 85 percent of people in developing countries still not receiving family planning services
—more research on contraceptives
—greater integration of population in development planning
—better understanding of economic, social, and cultural determinants of fertility, and policies to influence them

VIII

Private Capital Flows to the Less-Developed Countries

Complementary to official U.S. development assistance and other official capital outflows to the developing world are direct equity investments and portfolio lending from the U.S. private sector. As concessional development assistance is increasingly concentrated on the countries most severely affected by the energy and food situation, the remaining developing countries will rely increasingly on private sector resources for their capital needs. A number of these countries have already benefited greatly from their access to private capital inflows as well as official development assistance and have made such progress that they have a sharply declining need for concessional assistance in any event. Thus, for a growing group of developing countries, their principal interest in U.S. policies for development lies in the areas of access to private capital and the conditions of foreign trade. The trade issues are covered in other sections of this report.

There has been a great increase in lending to developing countries through private capital markets in recent years. As these world capital markets change rapidly under the stress of recent events, there is widespread interest in assuring continued if not increased access to these markets by the developing countries. While portfolio and direct lending to the developing countries from the U.S. is substantial, it has raised fewer issues and controversy in recent years than U.S. private direct foreign investment, most of it by the large multinational corporations.

Direct foreign investment usually involves transfer of technology, management skills and marketing techniques as well as transfer of capital. Consequently, it involves some degree of direct control over the resources of the country by a foreign entity. Controversy over direct foreign investment is by no means confined to the developing countries, as shown by the long history of discussion in Europe, Japan, and even the United States. There is also controversy over the effects on employment and wages in the U.S. from U.S. direct private investments abroad. If direct private investment were not such a dynamic and transforming agent in many economies, much of this controversy would not exist; but all concerned generally agree that the activities of modern business are a powerful force for change and modernization. Thus many countries are concerned with controlling direct foreign investment to ensure that the extraordinary productivity of the modern multinational corporation is used to their own advantage.

There have been many disputes over foreign investments and it is not easy to reconcile the claim of many developing countries that the foreign investor has no right to invoke the protection of his home government with the positions taken by the U.S. Congress and the Executive Branch on securing prompt, adequate and effective compensation when U.S. investments are nationalized. While admitting that differences at times cannot be easily reconciled, the U.S. has sought to mitigate the effects of disputes and remove them from the forefront of intergovernmental relations. Efforts are underway to develop new techniques to accomplish this.

While direct private investment often brings large benefits to the host country, this need not always be so. Excessive protection for domestic manufacturing by tariff and other controls or incentives established by the host country can lead to direct investments from the U.S. or elsewhere that are profitable for the private firm but of little or no social benefit for the host country. Such favorable environments for foreign investment may be established through a strong desire by the host country to industrialize and modernize, or as an unforeseen effect of measures to solve a balance of payments crisis, and the responsibility for the measures rests with the host country. In such circumstances, direct private investment may respond well to market incentives and behave competitively in the local market, yet still not assist the overall development effort of the country because of the price system the country has structured. If later the host country wishes to restructure its price system and incentives in a way better designed to promote development, difficult questions arise between improving efficiency in the country and equitable treatment of foreign investors. Indeed, the U.S. has suggested in OECD discussions that at least among developed countries these artificial incentives to attract investments are inappropriate.

There are no simple answers to questions on U.S. promotion of direct foreign investment in the developing countries, and what form the stimulus, if any, should take. There are also no simple answers to the position the U.S. should take when foreign governments revise their policies in ways that may adversely affect specific U.S. direct private foreign investments. Considerations of both the welfare of U.S. firms and of the development prospects of the developing countries must be taken into account and balanced upon occasion in formulation of policy for direct private foreign investment.

A. *U.S. Private Direct and Portfolio Investment in Developing Countries*

U.S. private capital flows to less-developed countries remained substantial in 1973, the latest year for which complete data are available. The total book value of U.S. private direct investment in less-developed countries at the end of 1973 was nearly $28 billion compared with $25 billion at the end of 1972. Over half of this investment is located in Latin America. Direct investment flows to Latin America and to other developing countries in the Western Hemisphere totaled $.7 billion in 1973, up from $.3 billion in 1972. Outflows to less-developed countries in Asia and Africa, however, decreased somewhat. Total equity investment in 1973, including reinvested earnings, was $2.7 billion, net, for all less-developed countries.

Additions to petroleum investment in less-developed countries amounted to $1.1 billion in 1973, about the same as the prior year. Reinvested earnings, however, replaced net capital outflows as the primary source of funds. The decrease in capital outflows is partly attributable to decreases in U.S. assets in several Latin American countries.

U.S. direct investment in manufacturing in less-developed countries increased by $1.1 billion in 1973. The percentage increase in investment was about the same as the percentage growth in U.S. manufacturing investment in developed countries.

Income from U.S. private direct investment increased significantly, primarily due to large gains in petroleum earnings.

Portfolio investments and long-term lending to the developing countries increased by $1.2 billion net in 1973, investments in foreign securities by $510 million, and long-term lending by $705 million.

The accompanying tables provide additional information on levels of U.S. private direct and portfolio investment to less-developed countries in 1973.

Figure 36

Preliminary 1973 Estimates of U.S. Private Direct Investment in Developing Countries (by Area)
(Millions of $)

Area	Book Value at year end	Earnings	Net Capital Outflow
Latin American Republics	14,797	2,089	376
Other Western Hemisphere[1]	3,655	539	296
Africa[2]	2,830	618	—427
Middle East[3]	2,682	2,277	588
Asia and Pacific[4]	3,903	1,014	365
Total Developing Countries	27,867	6,538	1,198

[1] Excludes Canada
[2] Includes Egypt and all other countries except South Africa.
[3] Includes Bahrain, Iran, Israel, Jordan, Kuwait, Lebanon, Qatar, Saudi Arabia, South Yemen, Syria, Oman, United Arab Emirates and Yemen.
[4] Excludes Japan, Okinawa, Australia and New Zealand.

Source: *Survey of Current Business,* August 1974, U.S. Department of Commerce

Figure 37

Preliminary 1973 Estimates of U.S. Private Direct Investment in Developing Countries (by Sector)
(Millions of $)

Sector	Book Value at year end	Earnings	Net Capital Outflow
Mining and Smelting	2,709	306	—32
Petroleum	10,431	4,247	247
Manufacturing	7,830	1,104	467
Other	6,896	881	516
Total	27,866	6,538	1,198

Source: *Survey of Current Business,* August 1974, U.S. Department of Commerce

Figure 38

Revised 1973 Figures for Net U.S. Private Capital Flows to Developing Countries (by Area and Type) [3]
(Millions of $)

Latin American Republics and Other Western Hemisphere [1]		259
Foreign Securities	107	
Claims reported by U.S. banks	60	
Claims reported by U.S. non-banking concerns	92	
Asia and Africa [2]		956
Foreign securities	403	
Claims reported by U.S. Banks	457	
Claims reported by U.S. non-banking concerns	96	
Total		1,215

[1] Excludes Canada
[2] Excludes Japan, Australia, New Zealand and South Africa.
[3] Excludes short term capital flows (liquid and non-liquid) totalling $2,548 millions—Latin America, $1,834 million; Asia and Africa, $714 million.

Source: *Survey of Current Business,* September 1974, U.S. Department of Commerce

B. *The Impact of U.S. Direct Private Foreign Investment on the Domestic Economy of the U.S.*

The book value of U.S. direct investments abroad was $107.3 billion at year end 1973. These U.S. private direct investments, largely by U.S. multinational companies, and the investment income receipts remitted by foreign affiliates to parent companies, contribute favorably to improving the nation's balance of payments position.

Although U.S. international direct investments are considered "adverse" to the U.S. balance of payments position at the time recorded because they represent outflows of capital, remittances of dividends, profits, and other investment income to the United States in subsequent periods represent a positive contribution to the nation's balance of payments position. The inflows of investment income (interest, dividends, and branch earnings) on direct investments from developing countries amounted to almost $5 billion in 1973, or $1.7 billion above the previous year. Adding to this, fees and royalties sent back by foreign affiliates in developing countries push the nation's return on direct investments upward by another $650 million.

In contrast, the value of direct investments in the U.S. economy from the developing world amounted to only $1.3 billion at year end 1973, compared to investments of over $16.4 billion from developed countries. U.S. payments in the form of interest, dividends, and branch earnings to developing countries were only $227 million compared to almost $665 million paid to foreign investors in the developed world. Much the same spread exists with respect to foreign participation in U.S. portfolio investments. In 1973, all foreign investors owned almost $37 billion of U.S. securities; but investors of the developing world held only $3.5 billion of these issues.

To bring U.S. Government statistics on foreign direct and portfolio investments in the United States up to date a study by the Departments of Treasury and Commerce is under way analyzing the magnitudes and impact of such investments on the U.S. economy. This study is authorized under the Foreign Investment Study Act of 1974 (PL 93-479). An interim report will be submitted to Congress in November 1975, with the final report due in May 1976.

There has been much controversy over the effect of U.S. direct investment in the less-developed countries on levels of employment and working conditions in the U.S. Numerous investigators are attempting to provide insight into these questions, but definitive and conclusive results have not yet been obtained.

Depending on the assumptions made, investigators have noted that one might expect either positive or negative changes in U.S. employment resulting from U.S. direct foreign investment. These assumptions involve such issues as whether it is an investment in a sales, assembly, or production facility and the expected reaction of foreign competitors to U.S. firms. If the investigators conclude that the direct foreign investment was necessary to avoid losing the foreign markets to European, Japanese or local competitors, as has been done in some intensive case studies, it follows that the investment has a favorable effect on employment in the U.S. as well as on the U.S. balance of payments.

If the investigators conclude that the investment replaces some U.S. production, the conclusions on U.S. employment are less favorable. Whatever its magnitude, the employment issue is one of displacement, unemployment, adjustment, reemployment, and possible wage loss rather than one of complete and permanent loss of income and job. It is not possible at this time to be conclusive with respect to the likely magnitude of these adjustment costs.

C. *Issues and Options for U.S. Direct Private Investment*

It is U.S. policy to encourage direct private investment in the developing countries. To carry out this policy, private direct investment in the developing countries is offered insurance against political risks, and the tax laws have special provisions for investments and income in the less-developed countries.

1. *Investment Insurance for U.S. Direct Investment*

The Overseas Private Investment Corporation (OPIC) was created by the Foreign Assistance Act of 1969 to take over the programs operated previously by AID. Its programs of political risk insurance (inconvertibility, expropriation, war), loan guarantees, and other services are designed to facilitate the participation of U.S. private capital and skills in the economic and social progress of less-developed friendly countries and areas, thereby serving basic foreign policy objectives of the U.S. A primary objective of OPIC is to carry out its programs on a self-sustaining basis at no cost to the American taxpayer. The OPIC Amendments Act of August 27, 1974, which extended OPIC's operating authority to December 31, 1977, calls for special attention to investment in the lowest income countries as well as to overseas investment by small U.S. businesses.

The volume of OPIC business has grown substantially since the agency was created. In FY 1974, OPIC issued $995 million of new political risk insurance, up from $695 million in FY 1971. The insurance covered $282 million of a total $475 million invested in projects in 32 countries. Coverage is extended only to projects that will benefit both host country and U.S. employment and balance of payments. OPIC's financial position has continued to strengthen. Despite potential claims of

$420 million when OPIC opened for business in January 1971, its insurance reserve has grown from $85 million to $181 million at the end of FY 1974.

The 1974 legislation calls for initial steps on a trial basis toward a major restructuring of OPIC, and the transfer by 1980 of OPIC's investment insurance underwriting activities to private insurance companies, multilateral organizations, or others (for example, an association of insured investors). Congress hopes for OPIC's role to be solely that of a reinsurer by December 31, 1980. A joint OPIC-private insurance company group to insure for expropriation and inconvertibility has begun operations in 1975. During a three-year test period, OPIC will act as a partner in the group, provide administrative services and reinsure the group against "excess loss" above $40 million per country and $80 million globally per year. OPIC purchased reinsurance on its expropriation portfolio with Lloyd's of London and others, and has negotiated inclusion of inconvertibility risk in the reinsurance plan. A user-owned insurance company for private participation in OPIC's war, revolution and insurrection portfolio is to be created by January, 1976. The legislation provides for a Congressional review of OPIC's progress toward "privatization" in 1977. By that time there should be evidence as to the feasibility of a political risk insurance program partially operated by the private insurance industry and the contributions it can make to the developmental goals of the United States.

2. *U.S. Tax Policy on Investments in the Developing Countries*

The flow of private financial resources to developing countries is influenced by the tax treatment received under U.S. law. The tax treatment given foreign investments by the host country, and coordination of tax treatment between the two countries are also important.

Investment in subsidiaries of U.S. companies in the less-developed countries benefit, as do all such U.S. investments in foreign countries, from not having their profits subject to the U.S. income tax until the profits are repatriated to the U.S. from the country in which they are earned. Since 1962 the U.S. tax code has provided for different treatment of U.S. investments in the developing countries from those in the developed countries. Although the intent of the 1962 revisions was to provide a more favorable tax treatment for investments in the developing countries, there has been little evaluation of their effects.

The principal differences in tax treatment are in the income tax on repatriated corporate earnings from subsidiaries. When profits are remitted from developed countries, the U.S. income tax is determined by adding the foreign taxes already paid on them to the profits remitted, calculating the U.S. tax due on the sum, and then taking a tax credit for the foreign income taxes paid. When profits are remitted from developing countries, the U.S. income tax is calculated on the actual remittance (including any foreign withholding taxes), but the credit given for the foreign taxes previously paid is only partial. The net result to the investor depends on the foreign income tax rate on profits. If it is lower than the U.S. rate, profits remitted from the developing country pay a lower total tax than profits remitted from developed countries. If the foreign tax rate on profits is higher than the U.S. rate, this advantage disappears and can become a disadvantage. It is estimated that the differential treatment given profit repatriated from the less-developed countries reduced U.S. tax collections $55 million in 1972, but no estimates are available on the actual effects this tax provision had on encouraging or discouraging U.S. investment in the less-developed countries, or on total taxes paid.

Another incentive is that retained earnings receive capital gains treatment when a corporate subsidiary in a less-developed country is liquidated after ten years or more. By contrast, the retained earnings of a developed country subsidiary being liquidated are treated as an ordinary dividend. In practice, the incentive does not favor the investor in the less-developed country if foreign income tax rates on the subsidiary are higher than a certain level, and may instead work as an incentive to remit dividends earlier rather than reinvesting them until the subsidiary is liquidated.

On balance, the current U.S. tax laws probably provide little incentive for investment in the less-developed countries. Congress and the Administration last year considered modifications in the special tax benefits to investment in less-developed countries. Although no amendments were enacted then, some of these issues may be dealt with in the context of general tax reform during this session of Congress. There seems to be a fairly broad consensus that provisions which provide tax benefits on a non-selective basis are not an efficient way of bolstering the development process in less-developed countries. Efforts to modify the decision-making process with respect to investment in less-developed countries should focus the availability of U.S. tax or other benefits on those countries or those types of investment where investment promotion is in the mutual interest of the U.S. and the host country. Bilateral income tax treaties with the less-developed countries can be useful to improve tax treatment of investments in these countries.

3. *The Activities of U.S. Multinational Corporations (MNCs) in the Less-Developed Countries*

There is no dispute over the major importance of multinational corporations in providing capital and technology flows to the less-developed countries, the establishment of their domestic industries and training of skilled manpower. There is dispute about their impact on the balance of payments of both the U.S. and the less-developed countries. There has been intense discussion of the benefits that multinational corporations bring to the host country, to the U.S. and finally to the company itself. While their critics in the U.S. accuse them of exporting jobs from the U.S. and hurting U.S. workers, their critics overseas accuse them of exploitation and monopolistic practices.

It is of interest to review the charges that have been made against the multinational corporations and the measures for control that have been proposed.

On the one hand, there are expressions of concern by the developing countries that MNCs are too big, are able to evade national controls, do not contribute enough to achieving national objectives, and interfere in internal domestic affairs. At the same time, it is argued that most MNCs have monopoly or oligopoly power and that the less-developed countries can obtain a bigger share of the benefits resulting from foreign investment by exercising economic power of their own.

The principal means by which less-developed countries have sought to strengthen their bargaining position vis-a-vis MNCs is the use of national or regional restrictions of various types. One of the most comprehensive is the investment code of the Andean Pact nations (Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela). Among other provisions, the Code requires phased disinvestment of foreign majority equity positions in a number of sectors. It also places limitations on reinvestment and remittance of profits and on technology transfer agreements. A number of other developing countries have taken or are taking similar steps.

Another type of less-developed country action against MNCs is abrogation or forced renegotiation of concession contracts sometimes coupled with outright expropriation. This tactic has been and is being used by the member states of producer cartels such as OPEC and IBA (International Bauxite Association). Individual less-developed countries are also increasingly conditioning their approval of new MNC investments on guarantees of fulfilling certain quantitative goals such as jobs, exports, or local value-added.

The MNCs have also come under criticism for their role in the transfer of technology. They are accused of charging too much for their technology, transferring technology that is too capital intensive or for inappropriate products, failing to do research and development in the less-developed countries, restricting trade in manufactures with export prohibitions, tie-in sales, sole source requirements, and numerous other failings. In reaction, some less-developed countries have passed laws which severly regulate the technology transfer process, and there is continual pressure for a "code of conduct" which the developed countries should agree to and enforce on the multinational corporations to ensure that they transfer their technology on terms acceptable to the less-developed countries.

Parallel to these national and regional actions, developing country interest has grown in having MNC issues examined in international forums. Since it is recognized that binding international regulation of MNCs is not feasible any time soon, much of the thrust of the less-developed country initiatives in multinational organizations has been to gain international acceptance of national regulation of MNCs, and of regulatory codes of behavior.

Probably the most significant recent international action on MNCs was the decision by the UN Economic and Social Council at its December 1974 meeting to establish a permanent United Nations Commission on Transnational Corporations and a research and information office in the U.N. Secretariat. Establishment of a UN commission was one of the recommendations contained in the June 1974 report of a group of twenty "Eminent Persons." Among its members were Senator Jacob Javits and US businessman J. Irwin Miller.[1]

In addition to ECOSOC, the United Nations Conference on Trade and Development (UNCTAD), the International Labor Organization (ILO), the United Nations Commission on International Trade Law (UNCITRAL) and the Organization for Economic Co-Operation and Development have all launched studies concerning the activities of MNCs which are most relevant to their particular areas of interest. All of these studies and the terms of reference of the new UN Commission give a high priority to developing codes of conduct concerning MNCs, which most less-developed countries interpret as including only principles to be observed by corporations.

The Charter of Economic Rights and Duties of States which was adopted by the UN General Assembly in December 1974 sets forth the rights of less-developed countries vis-a-vis MNCs but says little of their obligations, particularly in the area of expropriation of foreign assets. The unsatisfactory treatment of this point is one of the main reasons that the United States and several other developed countries voted against the charter.

[1] Senator Javits, Mr. Miller, and several other Eminent Persons supported creation of a UN Commission on MNCs but dissented from some of the other recommendations in the report.

The U.S. Government believes that private foreign investment by MNCs can be a major factor in promoting economic development in the less-developed countries and that there need not be an adversary relationship between these countries and MNCs. It also recognizes the complexity of the issues that may arise and is seeking to develop solutions to problems as they arise in ways that will avoid confrontation and acrimony.

The U.S. Government is participating in the various international forums which are studying MNCs. It is also strengthening its cooperation on international investment and MNCs with the other developed nations through the OECD, which established a special committee in January 1975 to deal with MNC and investment issues. It is hoped that the new UN Commission on MNCs will serve as a focal point for constructive discussion of MNC issues with the less-developed countries. If the Commission is able to consider the issues objectively, it can promote better understanding between governments and corporations and thus help to ensure that MNCs will continue to play their vital role in development.

4. *Investment Disputes* The U.S. views private investment as an important contributor to economic development through direct transfer of resources and technology as well as by stimulating formation of domestic capital within the recipient country. Yet the climate for it is adversely affected by investment disputes between foreign investors and less-developed countries.

While such disputes concern many kinds of investments, U.S. companies engaged in natural resource extraction and processing seem most vulnerable, although banking, insurance and public utilities are also frequently involved. Geographically, the number of investment disputes in a less-developed region is related to the total amount of U.S. direct investment in the region; for example, more than one-half of the disputes are in Latin America, where more than one-half of the U.S. direct investment is located.

A recent trend is the tendency of host governments to take actions expropriatory in effect, but which stop short of formal nationalization. These include interventions, requisitions, coerced sales, forced renegotiations of contract or concession rights, and confiscatory taxes.

One apparent cause of investment disputes is rising economic nationalism—the desire of host governments to exercise greater control over their resources and economic processes, and to obtain a greater share of economic benefits from their use; the result is often greater selectivity regarding the amount and type of foreign investment permitted, and more stringent terms of entry and operation.

Another cause may be the recent supply shortages in many basic commodities; producing countries which were beneficiaries of rising prices for raw materials have enhanced leverage vis-à-vis consumers, and were better able to finance the takeover of foreign enterprises.

The U.S. recognizes the sovereign right of countries to nationalize the property of foreign investors, provided it is accomplished in conformity with international law. However, it often questions the wisdom of expropriating foreign investment. When inadequately compensated, it is unfair to investors, and harms the investment climate. It also increases the risk of inter-governmental confrontation. Even if compensation is paid, expropriation may divert scarce resources from other productive uses, perhaps impeding the attainment of development goals.

In many cases, compensation is paid as part of a negotiated settlement, and most disputes are resolved without active U.S. Government involvement. Terms of settlements vary greatly.

The present U.S. policy is to:

a. seek acceptance of the principle that international law imposes a minimum standard for treatment of foreign investors which requires a taking of property to be non-discriminatory, for a public purpose, and accompanied by prompt, adequate and effective compensation;

b. withhold new economic assistance from a country which expropriates a significant U.S. interest when it is determined that reasonable steps are not being taken to provide adequate compensation. The existing legislation calls for suspension of bilateral development assistance (unless the President determines that the national interest requires otherwise), for a negative vote on loans being considered in multilateral development banks, and for denial of trade preferences (unless a determination is made that such preferences would be in the national interest of the U.S.), to countries which expropriate U.S. property without taking appropriate steps within a reasonable time to discharge their obligations under international law;

c. encourage procedures such as arbitration to resolve investment disputes. We have signed and ratified (along with 64 other states) the Convention of the International Center for the Settlement of Investment Disputes (ICSID). OPIC incorporates arbitration provisions in its contracts with investors and in its bilateral agreements.

The Council on International Economic Policy's (CIEP) Interagency Staff Coordinating Group on Expropriation is the primary mechanism for reviewing expropriatory situations and for coordinating policy implementation. The Group is chaired by the Assistant Secretary of State for Economic and Business Affairs.

U.S. expropriation policy is not widely accepted among less-developed countries. Some countries, particularly in Latin America, reject U.S. positions on international law and international arbitration. They contend that local law applies exclusively to investment disputes. Arbitration is viewed as an unacceptable infringement of host country sovereignty.

Aid-related sanctions are ineffective when the host country receives neither U.S. bilateral assistance nor loans from development banks. Even when there is an active assistance program, sanctions or threatened sanctions may provoke a reaction which impairs chances of settlement. The existence of mandatory sanctions limits the flexibility to deal with investment disputes in ways which take into account the full range of U.S. interests involved.

For many of these reasons, it is difficult to determine if the outcome in any given case depends upon market forces, sanctions or threatened sanctions, diplomatic representations, the presence or absence of OPIC, a generalized desire for cordial inter-governmental relations, or other factors. It remains in our interest, however, to keep our policy under continuous review, and to take reasonable steps to attempt to minimize the incidence of investment disputes, and to assure fair treatment and just compensation for our investors when they occur.

IX

The Less-Developed Countries in the Evolving International Monetary System

In the last half decade, the international monetary system has been transformed. Although the initial impelling forces largely involved international payments among the industrialized countries, the resulting modification in the international monetary structure has affected the interests of the developing countries as well. The further shocks from the sudden and drastic increases of oil prices posed a substantial new problem for the international monetary system and caused a severe impact on the developing countries.

The International Monetary Fund is the focus of decisions on international monetary matters. Of the 126 members of the IMF, 99 are classed as less developed. The developing nations together hold about 1/3 of the voting power in the Fund, and thus can have an effective veto over amendments to the Articles of Agreement and certain other important decisions. Operating decisions of the IMF are made by a 20-member Board of Executive Directors. Nine Executive Directors are elected by less-developed constituencies, giving them a strong voice in Fund operations.

Following the U.S. actions of August 1971, which included, *inter alia,* the suspension of convertibility of dollars into gold and SDRs, it was generally agreed that there was need for a thorough review and reform of the international monetary system. A special committee which came to be known as the Committee of Twenty (C-20) was created to consider these issues. The C-20 included nine members representing the less-developed countries. Under the C-20 two technical groups were formed to study issues of special interest to developing countries. One focused on the use of the SDR as a means for providing development assistance and the other was established to consider other financial issues involving resource transfers to less-developed countries. During the course of these deliberations a major development occurred: in the face of severe exchange market pressures, the major countries abandoned their efforts to maintain their exchange rates in line with agreed par values; they allowed exchange rates to "float."

Recognizing that generalized floating among the major currencies would continue for the foreseeable future, the C-20 focused its efforts on measures to enable the international system to function in the period immediately ahead. Two bodies were established: the IMF Interim Committee to supervise the management and adoption of the monetary system and the "Development Committee" of the IMF-IBRD to continue work on the transfer of resources to developing countries. Each of these twenty nation bodies includes nine representatives from less-developed nations.

A. *Exchange Rate Flexibility*

A major issue in monetary discussions is the extent to which the system should promote increased exchange rate flexibility of major currencies as a means to balance of payments adjustment. On issues relating to exchange-rate flexibility, U.S. views have generally been substantially different from those of most developing countries. The United States favors greater flexibility. In contrast, the developing countries have generally resisted the movement toward more rate flexibility. They have only reluctantly accepted the need for the widespread use of floating rates in the current situation; most would prefer a general return by major currencies to par values, with maximum stability in parities with floating restricted to certain limited circumstances and subject to IMF approval.

Further differences have involved the nature of rules or guidelines for floating rates, in particular the extent to which the guidelines should encourage active intervention policies in the quest for more stability or maintenance of certain "target rates," or whether intervention should be generally limited to short-run smoothing operations and care taken to avoid heavy intervention that might perpetuate disequilibrium.

The less-developed country reluctance to accept greater exchange rate flexibility of major currencies frequently extends to their own rates. Some developing countries have felt that exchange rate adjustment was not an advantageous tool of payments adjustment for them. This has reflected a traditional belief that export volume was not very responsive to price changes and that a depreciating exchange rate would merely produce internal inflation and worsen their terms of trade. Thus, there has been a widespread maintenance of overvalued rates buttressed by high levels of protection and elaborate forms of exchange control.

An increasing number of important developing nations, however, have themselves adopted forms of rate flexibility, typically in the form of frequently adjusted par values or "mini-devaluations" rather than all-out floating. Their generally successful experience suggests that more less-developed countries would do well to make more use of rate flexibility. This conclusion is also supported by the results of recent studies showing that devaluation can be an effective means of adjustment for developing economies.

There may be developing countries whose economies are small, open, and narrowly specialized for whom greater adjustment through more frequent exchange rate movements may not be the optimal choice. For them a rate pegged to the currency of their major trading partner or stabilized in terms of a group of major trading currencies might be preferable when combined with reasonable implementation of internal measures to avoid disequilibrium. Another possibility is the formation of a currency union with other developing countries in order to achieve sufficient size and diversification to reap the benefits of rate flexibility *vis-à-vis* the rest of the world.

The problems for developing countries associated with floating rates among the major currencies which are usually cited include: (1) complications in exchange rate management; (2) complications in reserve portfolio management; (3) fluctuation in real debt burdens; (4) the need to establish forward exchange markets at some cost; (5) a general increase in uncertainty, in particular about export earnings.

If a developing country chooses to peg its exchange rate to the currency of a major trading partner, fluctuation of that currency *vis-à-vis* other major currencies will produce changes in the effective exchange rate of the less-developed country unrelated to its own situation, increase uncertainties about export proceeds and import prices, and complicate planning. This problem can become more difficult as developing countries increasingly diversify their geographical patterns of trade and payments (creating also some fear that pegging to the floating currency might inhibit this healthy diversification). Some countries are trying to attenuate this problem by pegging, instead, to an average of currencies weighted by importance in trade and payments, or to the SDR, which is now valued on a similar basis.

By similar reasoning, fluctuation in exchange rates can cause changes in the real value of reserve asset holdings and debt burdens. Diversification can provide a hedge against this kind of risk; however, the increased complexity of management will not be costless. Increased exchange rate flexibility in general increases the need for forward exchange markets in which international traders may hedge against exchange risk. This is often cited as an increased burden on less-developed countries, which generally do not have well-developed forward markets. In evaluating this cost, however, it is important to note that the only realistic alternative is not a world of perpetual exchange rate fixity, but rather one in which there is temporary stability interrupted by sudden sizeable rate adjustments. Such adjustments involve disturbance and costs to developing countries as well, and it is not clear that they are necessarily less burdensome than those involved in the more continuous, gradual changes of a well-functioning floating rate system.

Moreover, there are substantial benefits to be reaped by developing countries from an adjustment mechanism that operates more quickly to avoid the build-up of large payments disequilibria. Experience shows that such large imbalances promote various policies detrimental to the interests of developing countries—stop-go demand management policies, trade restrictions, restrictions on access to capital markets, cutbacks in and tying of aid flows, and the like. A flexible system will help impose objective and non-arbitrary discipline upon a developing economy. This can help to direct production and development and enable domestic leaders and planners to make decisions on rational bases while relieving them of the necessity of periodic and painful exchange rate decisions.

B. *International Reserve Assets: Gold, SDRs, and the Link*

The developing nations have taken a strong interest in the issues relating to international reserve assets—their composition, characteristics, rates of creation, and distribution among countries. On some of these issues U.S. and less-developed country positions are similar; on others, however, they are not. The developing countries have supported the consensus of the C-20 that the SDR should be placed at the center of the system as the *numeraire* and principal reserve asset, with the role of gold and reserve currencies reduced. International difference remains, however, on the precise roles that should remain for gold and reserve currencies and on the characteristics of the SDR that would best enable it to fill its enhanced role.

Along with recognition of the desirability of reducing the role of gold and reserve currencies in the system, and thus achieving more control over the generation of world liquidity, the developing countries have wished to maintain their freedom to hold a substantial part of their reserve asset portfolio in the form of currencies. By so doing they would be potentially able to exercise their own preferences. The United States has supported this position, believing that flexibility in official currency holdings is generally in accord with country preferences and provides a useful degree of elasticity to the system.

The gold issue has been complicated by the need felt by some countries to mobilize gold for use in official transactions[1]—a need made considerably greater by the added payments burden of oil-related deficits. European countries in particular have been pressing for arrangements to allow the use of gold to support their payments positions. The less-developed countries have been

[1] Gold has been effectively immobilized for use in official settlements by the wide gap that has developed between the official and private market prices. The IMF Articles of Agreement do not permit official gold purchases at a price above par value, and countries are reluctant to give up gold at a price roughly a fourth of the market price. Official gold can, of course, be mobilized through sales on the private market, but some governments are concerned that such sales could drive down the price sharply, in view of the relative thinness of the private market.

concerned that modifications of rules to allow official transactions at a market related price would strengthen the role of gold in the system, in contravention of the agreement reached in the C-20.

In addition to wishing to promote the objectives of reform, developing countries are concerned that agreement to mobilize gold as a reserve asset at a much higher market-related price would be contrary to their interests. The increase from any write-up in gold reserves would be distributed disproportionately; less-developed countries' gold holdings are only about 9 percent of the total holdings of national monetary authorities, and are only about 5 percent of their reserves, compared with 28 percent for the rest of the IMF countries. Moreover, the developing countries are concerned that the scope for net world reserve asset creation through new SDR allocations not be reduced by arrangements which destroy the reserve function of gold. (Developing countries currently receive 25 percent of SDR allocations.)

Figure 39

International Reserves
December 1974
(billions of dollars)

	Total	Gold	SDRs	Reserve Position in the Fund	Foreign Exchange
The United States	15.88	11.65	2.37	1.85	.01
Other developed countries	103.84	24.62	5.95	5.24	68.03
OPEC members*	46.64	1.48	.42	2.22	42.53
Other less-developed countries	32.79	2.34	1.49	.84	28.13

* Excludes Qatar, the United Arab Emirates and Gabon for which data are not available.

Source: IMF, International Financial Statistics, March, 1975

The United States has led the effort to assure that the role of gold in the international monetary system be gradually phased out in the interest of a stable and efficient monetary structure and substantial progress toward this objective has been achieved. At its meeting in January 1975, the Interim Committee agreed that the concept of an official international monetary price for gold should be abolished and that obligations on members to use gold in transactions with the IMF, as well as obligations on the IMF to accept gold from members, should be eliminated. The Committee also agreed that the various restrictions that distinguish gold from other commodities and give it special status should be eliminated, subject to special transitional arrangements designed to ensure that gold's role in the system is, in fact, reduced.

The principal remaining questions are what these transitional arrangements should be and what disposal should be made of the Fund's own gold holdings. The United States believes it is important to have arrangements that would effectively prevent the re-emergence of a *de facto* official or officially managed gold price, which would sharply limit official purchases during a transitional period. The United States also believes that the IMF should be enabled to dispose of its gold in an orderly manner, and possible arrangements to accomplish this are under discussion. The U.S. has proposed, specifically, that profits from the sale of a portion of Fund gold be used to aid the poorest developing countries through an IMF-managed trust fund (see below).

While it is generally agreed that the SDR should be altered suitably there is less agreement on how this should best be done. The question is complicated by uncertainty concerning the precise nature of future monetary arrangements, particularly exchange rate arrangements, and the role of reserve assets in the system. Other issues involve the set of rules that govern the amount of freedom countries have to use their SDRs, and the obligation of other countries to accept them. Also involved is the balance of adjustment pressures among deficit and surplus countries.

One set of questions was resolved at the C-20's final meeting in June 1974, when it was decided to raise the interest rate on SDRs[2] from 1½ to 5 percent, with

[2] Net interest payments are made by net users of SDRs (countries whose allocations exceed holdings) and received by countries with net acquisitions (holdings exceeding allocations).

provision for future adjustments to reflect changing money market rates in the major financial centers. This represented a compromise between those who wished a higher interest rate, in support of SDR strength, and those who felt too high a rate would place an excessive proportion of adjustment pressure on deficit countries. The transactions valuation of the SDR was also tied to a "basket" of the major trading currencies in order to provide a degree of protection against exchange risk for holders and users of SDRs.

Other issues related to a set of proposed IMF amendments governing the use and acceptance of SDRs. In general, the developing countries support these amendments, since they would make their SDR holdings more freely usable and increase the acceptance obligations of other countries. These amendments involve some highly technical issues.

Of prime interest to many developing countries, and a principal point of difference between developing countries and the United States is the distribution among countries of *new* SDR allocations. There are two separate issues involved. The first is whether the present system of distribution in proportion to IMF quotas adequately reflects the incremental demand of less-developed countries for reserves to hold, and thereby attains its objective of "neutrality" i.e., involves no permanent redistribution of real resources among countries. The second and more important issue—embodied in the less-developed country proposal for an SDR-aid "link"—is whether such neutrality is really desirable, or whether, instead, it would be appropriate and wise to use the SDR allocation vehicle for obtaining additional financial assets for the poorer countries not proportional to present quotas.

Quotas serve a variety of functions in the IMF, and a variety of factors has entered into the determination of relative quota sizes. In general, quotas are distributed in accordance with the overall financial and economic size of members and their international transactions. Formulas have been used to help guide quota decisions although the final decision rests with the discretionary judgments of the IMF membership. Political factors have an inevitable influence and have generally worked to increase the share for the less-developed countries. The factors in these formulas would certainly be relevant in an assessment of relative *levels* of demand for reserve holdings—national income, actual reserve holdings, foreign trade levels, and variability—but the developing countries argue that the weights used are not necessarily appropriate for this purpose; nor is it clear that incremental demands are necessarily proportional to levels of demand for reserve holdings.

Figure 40

IMF Quotas

	Millions of SDRs
United States	6,700
Other developed countries	14,400
Major Oil-Exporting countries	1,454
Other less developed countries	6,635

Developing countries, in addition to their relative high variability in export proceeds, have heavy dependence on imports in their development programs and relatively limited access to capital markets in which temporary payment gaps can be financed. Currently, the need for additional reserves by the industrialized countries may have been reduced by their current use of floating exchange rates, while most developing countries still peg their rates to a major currency. Additionally, the developing countries may have a relatively high social rate of return on real internal investment, which reduces the desirability of large reserve holdings. (Data suggest that, in practice, developing countries, other than the major oil exporters, tend to hold lower levels of reserves relative to IMF quotas than do the industrialized countries.)

These considerations, however, are essentially irrelevant for those proponents of an SDR-aid "link" who argue that, in a world of major inequalities in wealth and income, it is inappropriate for SDR allocations to aim at neutrality. They contend that larger SDR allocations should be channeled to developing countries deliberately as a vehicle for effecting a transfer of wealth and a flow of lending from rich to poor countries as a matter of equity, that is of relative resource need.

If it is accepted that additional wealth transfers and development lending to the developing countries are desirable, the question then arises whether it is wise to accomplish this aid via the "link." The major argument in favor of the "link" has already been stated: the desirability of increasing the share of poorer countries' claims to world resources.

Extra SDR allocations to developing countries could involve, in effect, a mixture of loans and unilateral wealth transfers. If the use of SDRs were interest free, and there were no obligation to repay, allocations of SDRs beyond needs for additional reserves could be used to obtain additional real resources from other countries with no counterpart liability. However, SDR use currently must be repaid ("reconstituted") to 30 percent of the original allocation, and net use involves interest costs at a rate roughly half the market rate. The element of wealth transfer is thereby reduced, and is partially replaced by an element of lending.

With the increase in the SDR interest rate, "link" proposals have often been accompanied by schemes to subsidize interest paid by developing countries on their net use of SDRs, so as to increase the grant element in linked allocations. Also, the need to "reconstitute" SDR holdings would be eliminated by one of the proposed amendments referred to earlier.

The major arguments against the "link" are that burdening the SDR with a secondary function, development finance, would weaken its ability to perform its fundamental monetary functions. There is concern that the SDR's monetary qualities would become subordinated to the new development function in the link proposal and that the effective "backing" behind the SDR would progressively become claims upon the weaker countries in the system. This concern, if it becomes manifest, may weaken confidence in the SDR, and inhibit the realization of objectives concerning its fundamental monetary role. The "link" would create political pressure on decision-making about the size of new allocations, leading to a tendency towards excessive creation, again weakening the SDR. U.S. opposition to the "link" has been based principally upon these concerns. We support the expansion of real resource flows to the developing countries but have not accepted the "link" as the appropriate instrument. In January the Interim Committee noted the continuing diversity of views regarding the "link". No further work by the IMF executive directors on possible amendments to the IMF Articles seeking to create the link was requested. The "link" issue will be kept under study as will alternative ways of increasing the transfer of real resources to developing countries.

C. *Less-Developed Countries and IMF Financing Facilities*

One of the basic purposes of the IMF, as laid out in the Articles of Agreement, is as follows:

> to give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity (Article I (v)).

The traditional mechanism for carrying out this function in the Fund is drawings under its general account. Drawings are made as a member purchases another member's currency with its own. In case of need a member may make purchases of as much as 25 percent of its quota in any twelve-month period, up to the point where the Fund's holdings of its currency equal 200 percent of its quota.[3] Since a member has normally paid 75 percent of its quota in a currency subscription and 25 percent in gold, its maximum drawings from the General Account can then total 125 percent of its quota, the first 25 percent known as a "gold tranche," the remaining 100 percent as four "credit tranches."[4] Access to the "gold tranche" is virtually automatic; the credit tranches are available under conditions of progressively greater stringency. Repayment is required over three to five years following the drawing; charges are assessed on a sliding scale from 4 to 6 percent

[3] These limits can, however, be waived by the Fund.

[4] When a member's currency is drawn by another member the former's access to general account drawings is correspondingly increased.

per annum, depending on the length of time a drawing has been outstanding.

Access to Fund resources is available to all member countries on identical conditions and terms. General account drawings have been administered flexibly, and many developing countries have made use of them. In an effort to adapt its procedures further to the needs of developing countries, however, the Fund has established certain special facilities. These special facilities are in principle available to all members; they are in fact tailored to meet the problems most frequently encountered by the developing countries.

The first of these facilities is the compensatory financing facility, established in 1963 to give special assistance to members who are vulnerable to fluctuations in export proceeds over which they have little or no control. Under this facility a member suffering shortfalls in its export proceeds can obtain drawings provided that the Fund is satisfied that: (1) the shortfall is of a short-term character and largely attributable to circumstances beyond the control of the member; and (2) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties. These tests and conditions are generally less rigorous than those applied to ordinary credit tranche drawings. Barring disasters and major emergencies, drawings under this facility are limited to 25 percent of quota in any 12 month period, and 50 percent of quota overall.

The second of the special facilities, established in 1969, is the buffer stock financing facility (See Chapter X on Commodities). This facility assists countries in balance of payments difficulties in meeting their financial commitments to international buffer stock schemes which have been set up to help stabilize export prices of primary products, e.g., tin and cocoa. Just as in the compensatory financing facility, drawings under the buffer stock facility can amount to 50 percent of quota. Drawings under the two facilities combined are limited to 75 percent of quota. Both facilities exist in parallel to the credit tranches. That is, Fund holdings of currency resulting from drawings under the compensatory financing and buffer stock facilities are excluded from calculation of total access to general account drawings (i.e., are not counted toward the 200 percent limit referred to earlier). Drawings under the compensatory financing scheme also do not affect a member's gold tranche position, but this is not true of buffer stock drawings.

There has been considerable utilization of the compensatory financing facility since its inception, with 32 countries making drawings amounting to a total value of over SDR one billion. Over SDR one-half billion was outstanding under the facility at the end of 1974. Various proposals have been made to liberalize the facility. These include modification in the formulas which are used to measure shortfalls in exports, a broadening of the concept to include compensation for increases in import prices, and liberalization of the facility as regards the quota limits on compensatory drawings.

There has been much less use of the buffer stock financing facility, owing mainly to the limited number of international buffer stock schemes that have been negotiated. Several suggestions have also been made to modify this facility. One of the principal suggestions is to allow drawings on the buffer stock financing facility to be excluded from calculations of a member's gold tranche position, as is the case for drawings under the compensatory financing facility.[5] Other proposals would liberalize the requirement for balance of payment needs, allow direct financing to buffer stock schemes, and liberalize amounts available relative to quota.

A third special facility of particular importance for developing countries was established in 1974, an extended facility to provide balance of payments assistance for members for longer periods and in larger amounts in relation to quotas than has been the practice under existing tranche policies. The new facility is designed to help countries whose balance of payments difficulties are rooted in serious structural maladjustments requiring programs of major economic reform that will lead to

[5] This would require an amendment to the IMF Articles of Agreement.

long-term payments adjustments. Such assistance will be provided in support of comprehensive programs designed to correct structural imbalances in production, trade, and prices, and to achieve the needed balance of payments improvement without policies inconsistent with the purposes of the Fund. Thus, before an extended arrangement is approved, the Fund must be satisfied that the problem is of this nature, and the member must submit a satisfactory program for achieving its goals and a detailed statement of policies to be followed over the next twelve months, with further such statements to follow at twelve-month intervals.

Resources available under this facility are limited to 140 percent of quota, and the Fund's holdings of a member's currency arising from its currency subscription. The combined use of this facility and drawings from the general account cannot exceed 265 percent of quota. Installment repayments are to be made over a period of from four to eight years after the drawing. Thus far there has been no use of the extended facility.

In 1974 the IMF Oil Facility was established to help countries meet the impact of increased costs of petroleum imports. This facility was devised to help both developed and developing countries requiring special balance of payments assistance as a result of the drastic and sudden increase in oil prices late in 1973. Maximum access to the facility was related to an estimate of increased oil import costs (adjusted by an allowance for an appropriate use of the country's own reserves) and also limited to relation to IMF quotas. About SDR three billion was obtained for the facility from direct commitments from oil exporting countries. Lending charges were related to borrowing costs, which amounted to 7 percent per annum in 1974, and drawings were to be repaid in installments over a period of from four to seven years following the drawing. All but SDR 0.9 billion ($1.1 billion, had been used by early February 1975.

The Interim Committee agreed to a 1975 oil facility of SDR five billion (about $6 billion). The Committee also endorsed a proposal to reduce, for the countries most severely affected by the energy crisis, the interest burdens payable by them under drawings from the facility. A proposed special account would subsidize the interest payments of MSAs. At this writing, the details of the proposal and sources of funds continue to be discussed.

The U.S. also proposed a special IMF-managed trust fund to provide highly concessional assistance to the poorest developing countries. Funds would be derived from a combination of donations and proceeds from the sale of a portion of the Fund's gold holdings. This proposal is at present under study by the Executive Directors of the IMF and World Bank.

The United States has supported many of the various innovations described above, although not necessarily in the precise form that might be preferred by many developing countries. As can be appreciated from the foregoing summary, the IMF has sought to be responsive to the particular needs of developing countries within the constraints of its basic objectives and legal structure. It may, however, be asked whether the interests of developing as well as developed countries would not be better served by a flexible approach to unified lending arrangements rather than a further proliferation of special-purpose arrangements.

Figure 41

IMF Facilities

Drawings under the general account (provides financing for short term balance of payments problems)
Compensatory Financing Facility (lends funds to compensate for export shortfalls)
Buffer Stock Financing Facility (lends to countries unable to meet commitments to international buffer stock agreements)
The Extended Facility (lends to countries whose balance of payments problems are not susceptible to solution in the short-run)
The Oil Facility (helps meet the increased cost of oil imports)

X

Commodities

World trade in primary commodities has been marked by turmoil during the past year. Diverse factors which normally affect trade in varying degrees and directions combined last year to produce exaggerated supply/demand imbalances and extreme price movements. Highlighting all these events was the successful increase in oil prices by the OPEC countries. Encouraged by this example, many developing country exporters of other primary products raised the possibility of collective efforts to increase commodity prices as their best potential source of foreign exchange for development. At the same time, industrialized countries concerned over possible future shortages of raw materials, gave increased attention to long-term growth of and access to supplies. Together, these developments prompted increased international interest on the part of producers and consumers in commodity agreements or other measures to influence supply, price and earnings.

Historically, commodity prices have fluctuated widely with most raw materials responding to the movement of the business cycle in the industrial countries and most agricultural products reacting, in addition, to crop growing conditions. Commodity prices languished during the world depression of the 1930's but rose rapidly after World War II and soared to record levels during the Korean War, outstripping price increases for manufactured goods. Thereafter, commodity prices followed a declining trend through 1962 while prices of manufactured goods continued their gradual rise. It was during this period that less-developed commodity exporting countries became particularly vocal about their "deteriorating terms of trade" and increased their efforts for commodity agreements or other international action to reverse the trend.

Through the mid and latter 1960's most commodity prices again showed a rising trend, more or less in line with manufactured goods. Then in mid-1972 non-petroleum primary product prices began to mount, rising more rapidly than manufactures, and reaching record highs at double their 1972 level by mid-1974. The sharp commodity price rise was mainly a result of the demand created by the worldwide boom in industrial activity, but raw material production difficulties, adverse weather, and forward buying as a hedge against high inflation and currency realignments also contributed to the general price increases. In addition, the petroleum price increases of late 1973 and 1974 exaggerated the already high prices of other non-fuel commodities, most of which require fuel for their production and/or extraction.

With the onset and deepening of recession in the industrialized countries in the latter half of 1974, the reduced demand for raw materials caused prices for many primary commodities to fall rapidly. The decline was felt most painfully by a number of developing countries. For the less-developed countries as a group, primary commodities represent four-fifths of total exports compared to one-fourth for developed countries. Moreover, nearly half of the developing countries earn more than 50 percent of their export receipts from a single primary commodity, and three-quarters of them earn more than 60 percent from three primary products, making their economies very sensitive to commodity market developments. As commodity prices have fallen, the buying power of the commodity producers has been further eroded by the continued increase in prices of their essential imports. Most hard hit by this situation are the poorest developing countries which must import their petroleum, most of their industrial requirements, and even much of their food.

A. *Commodity Agreements*

In the past, commodity agreements were generally sought by most less-developed, as well as some developed, country producers of primary products as a means to stabilize or raise prices in face of burdensome surpluses. The advantage to be gained from these agreements was viewed as accruing first to the producer and only secondarily to the consumer in the form of more stable prices. Formal agreements for such major commodities as sugar, wheat, tin, and coffee were negotiated during the surplus period of the late 1950s and early 1960s and achieved varied but limited success in stabilizing prices. However, as surpluses disappeared and prices shot up, the agreements proved much less effective as mechanisms for increasing supplies and controlling prices in the upper range. On the other hand, the grain agreement broke down in a time of surplus. All these agreements have tended to break down at precisely the times they were most needed. Thus, the economic provisions of the tin agreement are currently inoperative; the more recently concluded International Cocoa Agreement is currently in a similar state; and the current coffee, wheat, and sugar agreements have no economic provisions although they do serve as forums to exchange views and permit negotiations of new agreements. Efforts to reach international producer-consumer agreements for other commodities have not been successful.

The United States played a role in the negotiation of practically all these past international producer-consumer commodity agreements but has actually signed and participated in only the agreements covering wheat and coffee. We have also participated actively in numerous autonomous commodity study groups (e.g., rubber, cotton, tungsten, lead and zinc) and numerous other FAO-sponsored international bodies concerned with particular commodities (e.g., bananas, jute, rice, meat, etc.) as well as in the more general institutions which discuss commodity issues such as the FAO Committee on Commodity Problems and UNCTAD's Committee on Commodities.

Figure 42

Commodities Covered by Multilateral Agreements

Wheat*
Coffee*
Sugar**
Cocoa**
Tin**
Olive Oil**

* U.S. participates in agreement.

** U.S. does not participate but cooperates.

Figure 43

Commodities Not Covered by Agreements—But Discussed in an Inter-governmental Study Group

FAO

Rice
Grains
Citrus Fruit
Bananas
Tea
Oilseeds, Oils, and Fats
Meat
Jute Kenaf and Allied Fibers
Hard Fibers
Wine and Vine Products

UNCTAD

Tungsten

Autonomous Study Groups

Rubber
Lead and Zinc
Cotton
Wool

All the above agreements and groups involved producers and consumers in a joint effort to exchange information and discuss problems of mutual concern. The commodity agreements, in periods when they had economic provisions, were attempts to protect both consumers and producers from extreme price fluctuations. While attempts were also made in the past by groups of governments of producer countries to dominate the supply of one or another internationally traded commodity in order to raise prices, such efforts had no lasting success until OPEC increased oil prices in 1972-73. For example, attempts by the jute producers were undercut by competition from substitutes, and attempts by producers of sisal failed because one or more exporter did not observe its quota. Despite these unsuccessful experiences, OPEC's dramatic success at least for the time being has created intense interest among developing countries in the use of producer cartels to raise prices.

Notable among these emulative organizations is the Intergovernmental Bauxite Association (IBA) initiated in March 1974 by the seven countries which dominate world bauxite production. The members, subsequently increased to ten, pledged to achieve maximum national ownership and effective control over mining and to cooperate to ensure that operations of the multinational corporations in one producing country are not used to damage the interests of other member countries. Under the umbrella of this pledge of cooperation, Jamaica, followed by a number of other bauxite producers, imposed a substantial tax increase on foreign operators and extended the government's control over bauxite exploitation. However, the countries concerned appear thus far to recognize the limitations imposed by the availability of substitutes and the potential for shifting to alternative sources of aluminum bearing ores.

With quite different results, a group of Latin American banana producing countries launched a Union of Banana Exporting Countries (UPEB) to seek a higher return from their banana exports. Efforts to coordinate higher export taxes caused temporary havoc in the banana trade but did not achieve success because of the continuing oversupply of the fruit and conflicting competitive interests of major producers. The group has now decided to pursue its goals through the FAO-sponsored Intergovernmental Group on Bananas where consumer cooperation may be sought.

Governments of major producers of a variety of other primary products such as copper, iron ore, mercury, timber, and rubber have shown an interest in combining their efforts to improve their market position and bolster their earnings. Although they have attracted considerable public attention and concern that they constitute incipient cartels, these groups have either not yet mounted coordinated government action to manipulate the market or have taken only nominal steps in that direction.

The difference between the OPEC and banana experiences points up the pitfalls inherent in lumping all commodities together for analytical purposes. The success of a producer cartel will depend on many factors, including the number of producers, price elasticity of demand for the product and the availability of substitutes over the short and long-run. It will also depend upon the relative income needs of the producers and the extent to which they share economic and political objectives.

While it would be a mistake to generalize about the potential strength of producer associations and the threat of additional cartels, it is important to examine their changing characteristics and implications. Within the U.S. Government, a number of studies have been made in the wake of OPEC, and a U.S. Commission on Shortages and Supplies was provided for in legislation in 1974 (but has not yet been established). Among the many U.S. Government policy documents devoted to commodities, one significant one has recently been published by the Council on International Economic Policy. Dealing with minerals, the "Special Report: Critical Imported Materials" states that although "the problem of our securing adequate imports of critical materials is not one centered on our relations with developing countries, [they] are significant suppliers to us of some critical materials, most prominently bauxite, manganese, tin and natural rubber."

The report concludes that an outright export embargo like that instituted by the Arab oil producers in 1973 is unlikely to be carried out by other commodity producers because of their lack of sufficient political desire and economic strength. In the past, the report points out, mineral cartels usually have been attempted by private producers whose efforts were directed at long-term profit maximization. Such producers tend to avoid short-term gouging which might disturb the market and encourage substitution and/or additional production.

Since OPEC, the report adds, two new factors have created greater uncertainty that mineral exporters will continue to be deterred from pursuing a strategy of short-run revenue maximization by the likely longer-run demand and supply responses. First, ownership of mines and production facilities in developing countries has shifted to the host countries to such an extent that foreign majority ownership is an exception rather than the rule. Governments in these countries face short-term political pressures that may not be best served by maximizing their long-term economic gains, which may prompt them to try to reap immediate high profits. Second, the increased financial problems caused by high oil import prices are likely to add further to the pressures on these governments to obtain funds now to pay for vital imports. Such short-term efforts to manipulate supply and price could have an extremely disruptive effect on the economies of the importing countries with long-term as well as short-term implications. During the lead time of as much as five to ten years which is required to bring on new sources of supply for many minerals, considerable hardship could be inflicted upon the consuming countries in the form of price gouging, supply limitation, and indirect inflationary consequences. Once an expensive investment is made in the alternative source, pressures to protect it from lower cost sources of supply would tend to perpetuate inflated, uneconomic costs.

While U.S. vulnerability to disruption of supply or extreme price increases of non-mineral primary products is undoubtedly less great, the indirect effects of such market manipulation, even in tropical products, would be contrary to our interest in a smooth-functioning world economy. Moreover, developing country oil producers may respond to requests from other developing country commodity producers for support in their efforts to limit supply and raise prices. For example, Venezuela has established a fund to support the coffee price of its Central American neighbors. On the other hand, OPEC has thus far resisted developing country suggestions for a multi-billion dollar fund to create buffer stocks for the purpose of stabilizing primary commodity prices.

Increased congressional concern about access to supplies of critical raw materials, as well as about changing comodity trade relationships, is reflected in the inclusion in the 1974 Trade Act of the authority to enter into trade agreements with foreign countries in order to assure fair and equitable access to supplies of essential commodities. The Trade Act also provides the authority to enter into trade agreements which promote the economic growth of developing countries and where it is determined to be in the interest of the United States to enter into bilateral trade agreements. Although the precise nature of these potential agreements remain to be worked out, and will depend on the actual negotiations, they could have wide-ranging implications for both international trade in commodities and the trade potential of the developing countries.

The militance of developing country statements on commodity issues increased over the past year. At the Sixth Special Session of the UN General Assembly in April 1974 the overwhelming voting strength of the less-developed countries forced adoption of two resolutions with extreme provisions, a declaration of principles and a program of action for a New International Economic Order. These, together with a Charter of Economic Rights and Duties of States adopted by the General Assembly, advocated producer cartels to raise prices, and uncompensated nationalizations. The United States, in dissenting, responded that commodity trade problems are best dealt with through cooperative efforts of both producers and consumers. The opposing viewpoints, unless bridged, imply a continuing confrontation on these issues.

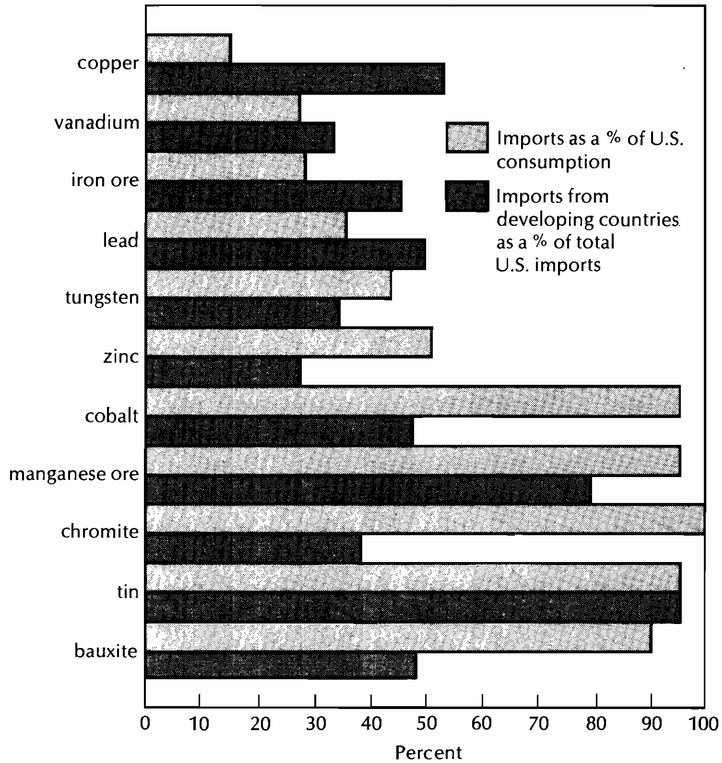
Developing country intentions to foster their solidarity were seen at the Dakar meeting of the non-aligned and other less-developed countries, prior to the Eighth Session of the UNCTAD Committee on Commodities, which met in Geneva in February 1975. If some oil-importing developing countries, in fact, are beginning to question the benefits of the OPEC cartel for themselves, these feelings were not made public at Dakar. The Declaration of the Dakar meeting repeated many of the now standard platform items of the Group of 77, particularly to raise primary commodity prices, as well as some form of "indexation" to tie these higher commodity prices to the rising prices developing countries must pay for manufactures. At the UNCTAD Commodities meeting, the principal topic of discussion was a proposal by the Secretariat for an "Integrated Program for Commodities." Abandoning the individual commodity approach of previous producer-consumer agreements, this proposal would set up a unified "buffer stock" scheme covering a dozen or more key storable commodities on which developing countries depend heavily for their export earnings. The scheme draws upon ideas propounded by Lord Keynes at the end of World

War II. The UNCTAD Committee agreed to give further consideration to the Integrated Program, the issues of which are both important and technically complex. While interested in the proposal, several developing countries displayed a cautious attitude, expressing a preference for early action on separate arrangements for individual commodities of interest to them.

A buffer stock financing facility was established in 1969 within the International Monetary Fund (IMF) to provide three to five year credits to help countries with balance of payments difficulties make a required contribution to an international buffer stock which meets certain criteria. To date only two international buffer stock schemes (tin and cocoa), of which only the tin scheme has ever acquired any stock, have been negotiated and qualified for support under the facility. The IMF facility has not been used more often largely because of the absence of operational international buffer stock schemes. Although the UNCTAD proposal is not spelled out in detail, one aspect of it would apparently be a large fund, dependent on contributions from many sources, which would provide financing directly to the buffer stock agency, rather than to the countries; and it could conceivably be achieved by amending the IMF facility.

Yet another approach is embodied in the export earnings stabilization scheme (STABEX) recently signed in Lomé between the European Community and a number of its associated developing states in Africa, the Caribbean, and the Pacific. Under the agreement, which is the first such arrangement between developed and less-developed nations to stabilize less-developed country incomes from exports of raw materials, the European Community (EC) established a fund of about $450 million to be used over a five-year period to provide compensation to signatories whose earnings from exports to the Community of eleven agricultural commodities and of iron ore fall below a minimum reference level. All but the poorest countries will be expected to repay the fund when earnings permit.

Figure 44
U.S. Import Dependence, 1973



Source: Special Report: Critical Raw Materials, CIEP, December, 1974

Given STABEX's present limited scope, it is unlikely to have a disturbing impact on world commodity markets. The formula for compensation will encourage the ACP states to maintain high exports to EC countries. Its chief significance, however, is the example it sets in providing some automatic mechanism to reduce the adverse impact of commodity price fluctuations on developing countries.

B. *U.S. Policy Implications*

The United States is the largest single consumer and importer of most of the primary commodities on which developing countries depend for income, and many of our industries are dependent on imports from them. We are also the major single producer or exporter of many of the foodstuffs which those countries must import. *(see chart no. 45, page 123)*

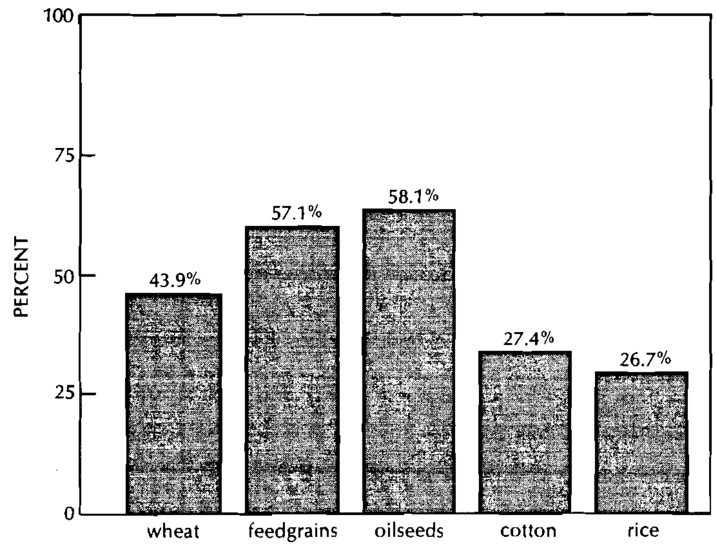
The rapid retreat of prices for a number or raw materials from their 1974 peaks is currently undermining the ability of many less-developed countries to pay for needed imports and is likely to increase the frustration of developing country governments and their inclination to challenge the existing world order. At the same time, the build-up of surplus stocks and expectations of low prices around the world may discourage further exploration and production and aggravate shortages in the next stage of the business cycle. While these phenomena have occurred in the past, some observers believe that given the increasing interdependence among countries, problems may intensify in the future, the cycles coming with increasing frequency and severity, competition between consumer countries for supplies growing, and producers taking more advantage of their market leverage during the peaks of business cycles.

Clearly, both developed and less-developed countries have an interest in averting the consequences of excessive supply and price instability. The question is how best to serve this mutual interest. In the past, the United States generally has been wary of commodity agreements because of our reluctance to tamper with the operation of the free market. However, we have participated in international negotiations and, in a limited number of cases, have signed agreements concerning raw materials produced by developing countries aimed at dampening extreme price fluctuation. As noted above, these agreements proved weakest in their ability to persuade producers to control supplies and in coping with upward price movements such as occurred in 1973/74.

Today there is a new concern about supply availability, particularly for critical minerals, and a new awareness that the United States is both a major exporter and major importer of raw materials. Moreover, there is greater recognition that because of inelastic supply and demand, imperfect information, government intervention, and lack of workable competition, raw materials markets often do not function well. Thus, many now contend that the fact that commodity arrangements have not worked in the past does not mean they should not be examined again in some form, keeping in mind that the characteristics of each commodity are different.

Commodity issues appear to be emerging at international meetings as a major developing country concern. It is likely that the less-developed nations will focus on this issue at the UN Special Session of the General Assembly in September 1975 and at the regular General Assembly session mid-term appraisal of the Second Development Decade. The renewed interest on the part of both ourselves and other countries has prompted a full examination of U.S. policy on commodities which is currently in progress. This review is considering, *inter alia,* the importance of commodities in our relations with developing countries.

Figure 45
U.S. Share of World Agricultural Exports, 1972—1973



Source: *Special Report: Critical Raw Materials*, CIEP, December, 1974

XI

Trade in Manufactured and Processed Goods

For most developing countries, trade in manufactured and processed goods is less important in their overall exports than is trade in primary products. However, processing and manufacturing obviously is important to them as one way to diversify and expand their economies. They view this as an area of high potential for expansion of their economic base with attendant employment benefits, and to achieve greater export earnings required to finance not only the rapid rise in cost of oil and other commodities but also the capital goods essential to the development of their economies.

The issue of industrialization, processing, and manufacturing is one of the agenda items that the developing countries include in their dealings with the developed countries, either individually or in international forums. Unfortunately, much of the discussion in recent years has been confrontational in nature in that the developing countries argue that world trading patterns have hampered the expansion of export trade of their manufactured and processed goods. They cite developed country tariff escalation against processed goods and manufactures and non-tariff barriers against many of their potentially dynamic exports as important factors in deterring progress in this sector. Part of the argument of the developing countries is that it is through trade that their economies can best be developed and if the developed countries really wish to assist, this can be done more effectively by providing freer access to their markets.

While many negotiations to reduce tariff and other trade barriers have been undertaken among countries since World War II under the framework of the General Agreement on Tariffs and Trade (GATT), a number of the developing countries did not participate in those negotiations nor, generally, did the developing countries feel their primary concerns were being addressed. They felt that reduction of tariffs resulting from the negotiations focused on the more heavily industrialized products which primarily benefited the developed countries.

A new round of multilateral trade negotiations (MTN) is now under way. Authority for the U.S. to participate in these negotiations was recently enacted under the Trade Act of 1974 (the Trade Act) (PL 93-618,88 STAT 1978, signed January 3, 1975). The Trade Act also includes, for the first time for the U.S., a section providing a generalized system of preferences (GSP) for beneficiary developing countries. While this section has come under criticism as being unduly restrictive in a number of areas by some of the developing countries, it does provide the U.S. with a tool to afford the developing countries greater opportunity for expanding their exports of manufactured and processed products to the U.S. market.

In sum, the principal issues of concern to the developing countries in seeking to expand their exports of manufactures and processed goods to the developed country markets are the developed country tariff structures and non-tariff barriers, their own effectiveness within the MTN and the effects of their own domestic trade policies and programs.

A major goal of the MTN is to strengthen and expand the world trading system *per se* which in itself is a spur to development. By drawing developing nations into the mainstream of the world trading system, it is hoped that the frictions and polarization that have occurred in the past will be reduced to the benefit of all nations.

There is specific recognition in the Trade Act of the need to consider the interests of the developing countries. As contained in Section 106, one of the negotiating objectives is "to enter into trade agreements which promote the economic growth of both developing countries and the United States and the mutual expansion of market opportunities." The Trade Act also contains many provisions concerning the need to avoid hardship to U.S. labor and industry stemming from imports.

Figure 46

Trade Act Provisions Benefiting Developing Countries

Tariff Reduction—authority to eliminate certain tariffs and reduce others up to 60 percent.
Non-Tariff Barriers—authority to reduce or eliminate non-tariff barriers or other distortions of international trade with differential treatment permitted where appropriate.
GSP—provision of duty-free treatment for eligible articles from any beneficiary developing country.

A. *Recent Trends of Trade in Manufactures and Processed Goods between the Developing and Developed Countries*

Over the past two decades manufactures have become an increasingly important part of developing country export trade. Between 1955 and 1973, the share of manufactures in developing country exports rose from 8 percent to over 20 percent. During this period of relative price stability these shifts in value largely reflected changes in volume. Between 1955 and 1973 the share of developing countries in world exports of manufactures increased from 4 to 6 percent. However, the major benefits of this increased role in world export trade of manufactures accrued to a relatievly small number of the richer developing countries. In 1971 and 1972, Hong Kong, Taiwan, Korea, Mexico, and Brazil accounted for approximately 60 percent of exports of manufactures to the developed countries.

In the 1955-1973 period imports of manufactures have increased from 58 percent to 66 percent of the value of total developing countries' imports. The following table indicates the role of manufactures in overall developing country trade over most of the past two decades:

Figure 47

Foreign Trade of Developing Countries, By Product Groups
(Billion dollars and percentages)

		Annual rate of change				Shares in the total[1]				
	1973 Billion dollars	1955-57 to 1958-60	1958-60 to 1969-71	1972	1973	1955	1960	1971	1972	1973
Total exports (f.o.b.)	(103)	1.7	7.2	18.5	(37½)	100.0	100.0	100.0	100.0	100.0
Agricultural products[2]	(32)	0.2	(3.0)	18.0	(35)	57.0	51.7	31.6	31.4	(31)
Non-fuel minerals[3]	(8)		(9.0)	5.3	(40)	9.9	10.6	9.1	8.1	(8)
Fuels[4]	(40)	4.8	9.0	18.9	(38)	25.2	27.9	38.4	38.6	(39)
Manufactures[5]	(22)	(4.5)	(15.0)	32	(41)	7.7	9.2	18.3	20.4	(21)
Total imports (f.o.b.)	(101)	2.4	6.9	2.9	(39)	100.0	100.0	100.0	100.0	100.0
Agricultural products[2]	(20)	(2.8)	(5.3)	12.3	(47)	22.7	22.6	18.5	18.4	(19)
Non-fuel minerals[3]	(2)	(4.8)	(10.7)	15.0	(47)	1.7	1.8	2.3	2.3	(2½)
Fuels[4]	(3)	−0.1	5.0	10.8	(36)	11.7	9.9	8.2	8.0	(8)
Manufactures[5]	(67)	(3.3)	(7.7)	14.2	(35½	58.0	61.3	66.7	67.5	(65½)

[1] Detail may not add to 100 as totals include non-classified traded goods (SITC 9).
[2] Food and agricultural raw materials (SITC 0, 1, 2 minus 27 and 23, and 4).
[3] Including non-ferrous metals (SITC 27, 28 and 68).
[4] SITC 3.
[5] Excluding non-ferrous metals (SITC 5, 6 minus 67, 7 and 8).
Sources: UN, *Monthly Bulletin of Statistics;* UNCTAD, *Handbook of International Trade and Development Statistics,* estimates.

B. *Tariff Structures and Non-Tariff Barriers in Developed Countries*

1. *Tariff Structures and Generalized System of Preferences*

Negotiations under the framework of GATT have done much to reduce developed country tariff levels on manufactured products. On the average, U.S. and European Economic Community (EC) tariffs on industrial goods have an *ad valorem* rate of some 8 to 9 percent. Canadian and Japanese rates are somewhat higher, averaging in the range of 10-13 percent. These averages, however, mask a problem of continued concern to the developing countries since many of the manufactured and processed products which they are able to produce and export have a higher tariff than the materials from which they are produced; this reduces their competitiveness in developed country markets.

Substantial developed country imports of raw materials and semi-processed goods enter either duty free or at low duties, whereas the duties on manufactured goods commonly imported from the developing countries (e.g., textiles, shoes, canned fruits, and juices) tend to be dutiable at rates higher than the averages cited above. The application of higher tariffs to processed or manufactured goods is the basis for frequent developing country charges of tariff escalation by developed countries. Since the value added in processing often is small related to total value and the tariff applied relatively large, it is often cheaper for the developed country to import the primary product duty free or at a very low rate and to manufacture or process the item itself.

Figure 48

U.S. Average Tariff Rates by Product Grouping
(including only dutiable products)

Primary products (non-agricultural)	4.4%
Semi-finished goods	9.5%
Finished manufactures	9.5%

Source: Department of State

On the other hand several developing countries (e.g., Mexico, Brazil, Korea, Taiwan) have not been prevented by the existing tariff structures from making rapid gains in developed country markets for a wide variety of exports of processed and manufactured goods. Also, the extension of generalized preferences by most developed countries over the past four years has reduced the extent of the tariff escalation issue. While the issue of tariff escalation may be somewhat defused by the introduction of GSPs, restrictions and incomplete coverage under each system will cause a continuation of concern by the developing countries that certain products are being effectively excluded by tariff escalation. It is an item that will be actively negotiated under the new round of MTNs. For the U.S. the Trade Act provides authority to negotiate elimination of existing duties of 5 percent or less *ad valorem* and the reduction by 60 percent of duties above 5 percent *ad valorem*.

The developing countries are also looking to the GSP as a vehicle for obtaining substantially more favorable access to developed country markets. The EC and Japan enacted GSPs in mid-1971 and Canada in mid-1974. The Trade Act, signed into law on January 3, 1975, has given the U.S. authority to provide duty free treatment for eligible articles to beneficiary developing countries. This authority is exercised outside the context of the MTN. On March 24, 1975, the President signed an Executive Order designating 89 countries and 43 territories as beneficiary countries for purposes of receiving GSP benefits. The proposed U.S. program, like the programs of other countries, will include a selected list of processed agricultural and primary products plus most manufactured products with certain import sensitive manufactured products excluded. Other countries' generalized preferences programs frequently include global quotas and tariff preferences which provide less than duty free treatment for the products covered. Developing countries will seek elimination or liberalization of those features as well as the limitations upon the extension of preferences currently contained in the U.S. act.

2. *Non-Tariff Barriers*

As issues of tariff barriers are lessened because of reduced rates and implementation of GSPs, the non-tariff barriers (NTBs) of the developed countries will be increasingly regarded by the developing countries as a constraint to further expansion of their exports of manufactures and processed products. Among the NTBs that have been of major concern to the developing countries are quotas, standards, subsidies, and countervailing duties.

Quotas exist on a number of developing country products; of these the best known are textiles. Under the aegis of a long-term arrangement regarding trade in cotton textiles under GATT, the U.S. has negotiated bilateral textile agreements with some 30 countries. The purpose in regulating textile imports is to provide for the orderly expansion of trade in textiles while preventing the risk of market disruptions in importing countries. The Arrangement Regarding International Trade in Textiles which became effective on January 1, 1974 continues to provide a multilateral framework for international trade in textiles and apparel of all fibers. Consistent with the Arrangement, the U.S. has endeavored to give special consideration to the developing countries in its bilateral negotiations.

The problem of standards is also alleged to be a substantial barrier to developed country markets, particularly for the smaller and less sophisticated of the developing countries. Health standards and requirements for packaging and labeling are complex and varied among the developed countries. In seeking to enter these markets, the developing countries need be aware of and be able to respond to the multitude of requirements. The time and effort to acquire this knowledge can be inhibiting when manpower resources are severely limited. The developing countries will seek some uniformity and concessions in these areas in order to gain a more effective access to developed country markets.

The concern of developing countries with subsidies and countervailing duties has become an issue of increasing importance as developing country exports have expanded and more pressure has been applied by U.S. manufacturers to impose countervailing duties. Less-developed country efforts to expand and diversify exports of manufactured and processed goods through a variety of export promotion programs, including tax rebates and outright subsidies, can, and on occasion have run afoul of the U.S. countervailing duty law.

Figure 49

Countervailing Duties—Notice of Receipt of Complaint Against Developing Countries*

Issued in 1974		Issued Jan. 9, 1975	
Korea	—rubber footwear	Korea	—non-rubber footwear; tie fabrics
Mexico	—steel	Mexico	—processed asparagus
Argentina	—non-rubber footwear	Argentina	—leather products
		Taiwan	—footwear
		Brazil	—leather handbags
		India	—cast iron soil pipe and fittings; cotton textile and man-made fibers

* A preliminary determination is required within six months of filing a petition or publication of a notice of investigation with a final determination to be issued within one year.

Source: Department of Treasury

The less-developed countries have taken the position that export subsidies are a legitimate means of promoting their exports of manufactured and semi-manufactured goods and that the GATT provisions pertaining to subsidies and countervailing duties should be adapted to meet their special needs. With regard to the U.S. the less-developed countries feel they should be exempt from the application of our law or at a minimum that the law, like that of other developed countries, should have an injury provision. The U.S. has stated that it will seek in the MTN a stronger international code on subsidies and countervailing duties which cover all products, and that in the context of such a code, it would be willing to consider the possibility of special treatment for developing countries.

The United States and other developed countries are being asked in the course of the multilateral trade negotiations to give particular attention to developing countries in the removal of non-tariff barriers to trade. This takes the form of requests for priority elimination of NTBs of particular interest to developing countries (e.g., those affecting tropical products). It also involves requests for preferred treatment under NTBs which cannot be eliminated (countervailing duties, anti-dumping charges, safeguards, government codes, etc.). Authority is provided in the Trade Act for the U.S. to negotiate the reduction or elimination of NTBs and other distortions of trade, and the Trade Act expressly provides that the benefits and obligations of any NTB agreement need not apply uniformly to all parties, if such non-uniform application is consistent with the terms of the agreement. Any agreement reached in these areas, unlike tariff reductions, must be submitted to Congress for approval.

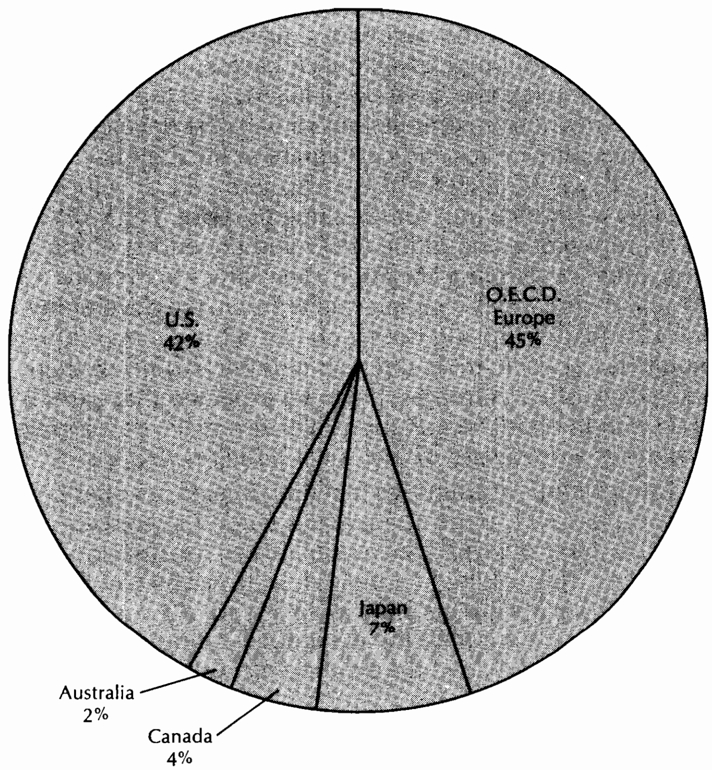
3. *Effect of Trade Negotiations on Developing Countries*

It is difficult to predict what the results of the trade negotiations will mean to the economies of the developing countries, but the participants in the negotiations committed themselves in the Tokyo Declaration opening the MTN to have the negotiations aim at increased trade benefits for the developing countries and substantial increases in their export earnings. The U.S. has accounted for a significant percentage of imports of manufactures from the developing countries.

Figure 50

OECD Country Percentage of OECD Imports of Manufactures from Developing Countries

1972



Source: OECD, Statistics of Foreign Trade, 1972

From 1962-1971 the U.S. increased its imports of manufactures from the developing countries at an annual rate of 12.7 percent while the EEC rate of increase during that period was 10.6 percent.

A number of steps have been taken to aid the developing countries in the negotiation process. Approximately $1.5 million of UNDP funds have been committed to projects being executed by UNCTAD and the UN regional economic commissions to help the developing countries prepare for and participate in the negotiations. The GATT Secretariat has also formed a developing country assistance unit for the same purpose. The work of these projects and of the GATT and the efforts of the individual developing countries themselves to prepare for the negotiations can be expected to make developing country leadership and bureaucracies more aware of their countries' specific trade interests and the barriers to their exports in other countries. It can be expected that participation in the trade negotiations will also make developing countries more aware of their own trade restrictions.

The developing countries feel that, in past negotiations within the GATT, trade concessions tended to concentrate on items of significance primarily to the developed countries. This resulted, in their view, from the fact that they have small markets and hence less to offer in the way of concessions than the developed countries. Some contend, however, that the developing countries would have profited to a greater extent had they participated more fully and vigorously in these negotiations.

As for tactics, the developing countries themselves continue to insist on a lowering of all barriers to their exports on a preferential, non-discriminatory and non-reciprocal basis. There are some who argue that developing countries could gain more if they would pull back from this position and be more willing to lower their own trade barriers. Such concessions could be used as a bargaining chip in seeking further reductions of restrictions of developed country trade policies, particularly as they apply to goods of special interest to the developing countries. In addition, it would provide grounds to seek support for such further trade liberalization from developed country exporters. And as the developing countries increase their exports, it is likely they will want to import more and would benefit from lowering their own trade barriers.

There is some probability that the developed countries will, to the benefit of developing countries, liberalize access to their markets for a wide range of tropical agricultural products in both processed and unprocessed forms, reduce tariff escalation on processed forms of many primary products, and lower barriers on a wide range of manufactured goods of export interest to the developing countries. At the same time, the general trade liberalization brought about by the negotiations will reduce the margins of preference enjoyed by developing countries under the various systems of GSP and special preferential arrangements provided by various developed countries. However, the tariff reductions agreed to under the MTN will be permanent binding obligations on the countries making them and are likely to cover a wide range of products, while tariff reductions under GSP are unilateral grants for 10 years and may be withdrawn without obligation. In addition GSP tariff reductions are subject to quota or competitive need limitations.

Reduction in trade barriers will not in itself result in significant increases in exports and export earnings of developing countries. The more liberalized market access provided by the various GSP systems has not automatically resulted in increased developing country exports into these markets. It is likely that developing countries will need assistance in marketing and export promotion to take advantage of the increased trade opportunities resulting from the negotiations.

While some generalizations have been made above on the effect of the MTN on the developing countries, there will be an obvious difference of interest and effect among these countries depending on their level of resources and structure of production. In the area of trade preferences, for example, the existing schemes under the GSP provide immediate benefit principally to the more advanced developing countries. Developing countries which have benefited from the GSP can be expected to attempt to have the systems liberalized to increase their market opportunities.

On the other hand, the many developing countries which have not significantly benefited from GSP also have an interest in pushing for liberalization of specific products within their production capability. They have pointed out that GSP provides market access opportunities for a broad range of manufactured goods, most of which they cannot expect to produce for many years. Simple manufactures which they can expect to produce, such as textiles and shoes, are considered sensitive areas of production by developed countries and are either excluded from the GSP schemes or placed under quantitative restrictions. More importantly from their point of view, many unprocessed and processed agricultural products which they might export, as well as the more processed forms of primary products which they now export, are frequently excluded from GSP schemes. There is some possibility that, as a part of the overall package to come out of the MTN, individual developed countries will improve their GSP schemes to provide trade liberalization in these areas so as to provide immediate benefits to a greater number of developing countries.

C. *Developing Country Trade Policies and Programs*

Trade policies of the developing countries themselves have significantly affected their ability to expand and compete for export trade in manufactures. Developing countries have traditionally intervened in their foreign trade through the use of tariffs, non-tariff instruments, and exchange rate policies, all having a substantial impact on their trade in manufactured and processed goods. They have generally controlled trade to a greater extent than the industrialized countries did at similar stages in their development or do now. Since the Second World War these trade barriers have been used extensively to foster the production of import substitutes to help alleviate recurring balance of payments crises and to stimulate industrialization. In conceiving these policies, starting in the 1930s developing countries were pessimistic about their export potential. They felt they could not increase their exports of raw materials enough to meet their balance of payments needs because of the expected slow growth of international demand for primary products. At the same time, they felt unable to increase significantly their manufactured exports due to their small industrial base and limited experience in developed country markets. By 1970 the labor force in the developing countries' industrial sector averaged only 15 percent of the total labor force.

Figure 51

Industrial Labor Force as Percentage of Total Labor Force

Region	1960	1970
Latin America	20	22
Caribbean	25	29
Africa	8	10
South and East Asia	11	14
West Asia	20	24
Average	12	15

Source: Industrial Development Survey (UNIDO), United Nations, 1974

Their import substitution strategies, using extensive and often haphazardly chosen controls, often resulted in widely varying levels of effective protection to different activities and arbitrary encouragement and expansion of inefficient industries. They tended to encourage underutilization of capacity and the adoption of inappropriate, capital-intensive technologies, as well as to discourage productivity growth since entrepreneurs were commonly assured of substantial profit margins in protected domestic markets. They commonly did not result in improved savings performance or better income distribution. At the same time, such policies created serious disincentives to exports because they raised the costs of imported inputs for domestic manufacturing industries and allowed an overvaluation of the exchange rate.

To escape the inefficiencies caused by trade controls, some developing countries started shifting industrialization policies in the 1960s to be more "outward-looking" and to keep industrial markets more in touch with the structure of world prices. The most notable examples are in Korea, Taiwan, and Brazil, although many other developing countries have now moved toward more open economies as well. With a lowering of protection and the development of a variety of export promotion programs, manufactured exports increased from 7 percent of total developing country exports in 1953 to over 20 percent in 1973. The rate of growth of manufactured exports was particularly spectacular precisely in those countries which liberalized their own trade policies: Korea, Taiwan, and Brazil. Despite this increase, the developing country share of total manufacturing output in 1972 was only 6.9 percent which was broken down by region as follows:

Latin America	54.6%
Asia	37.3%
Africa	8.1%

Source: Industrial Development Survey (UNIDO), United Nations, 1974

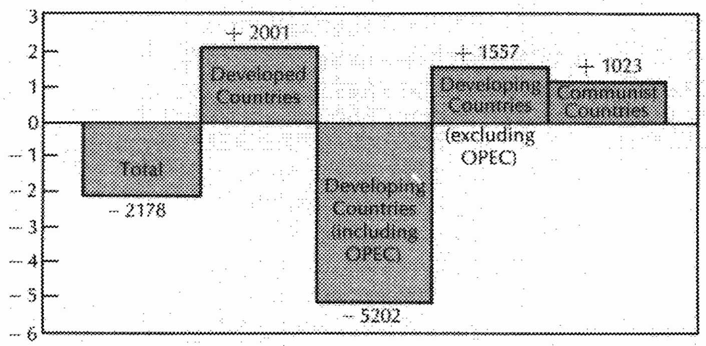
The liberalization of trade barriers increased developing country imports as well as their exports. More open policies in these countries have tended not only to benefit their own economies but also to increase the exports of the developed world, including the U.S. The total imports of developing countries from the U.S. increased from $7.7 billion in 1960 to $14.6 billion in 1972, representing in the latter year 33 percent of total U.S. exports. The following table indicates the U.S. balance of trade in 1974 by region and provides a comparison of the role of the developing countries in U.S. trade.

Despite these policy shifts to more open economies, there are still many trade barriers in developing countries. In many instances the export promotion policies have consisted of governmental compensation for existing trade barriers (e.g., over-valued exchange rates or high tariffs on some of the imported inputs of export industries). The U.S. has encouraged developing countries to adopt freer trade policies. Many AID program loans gave balance of payments support in the transition period until new measures resulted in increased exports. The U.S. also has supported efforts in this direction made by the International Monetary Fund and World Bank Group.

In seeking to further expand their exports, a number of the developing countries have grouped together to form free trade areas or some type of customs union to take advantage of economies of scale and specializa-

Figure 52a

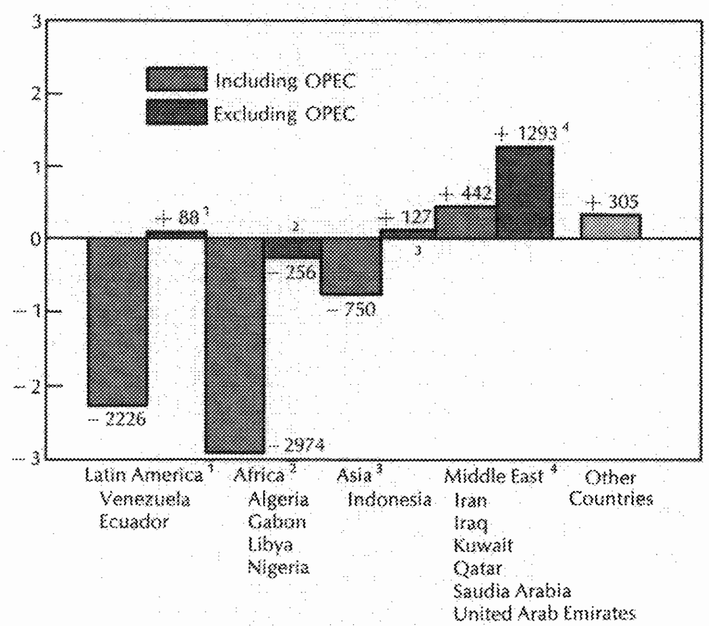
U.S. Trade Balance
1974 Jan.-Sept.
(millions of dollars)



Source: Direction of Trade, IMF/IBRD, Dec., 1974

Figure 52b

U.S. Trade Balance with
Developing Countries by Regions (1974 Jan-Sept)



Source: Direction of Trade, IMF/IBRD, Dec., 1974 tion in larger markets. The U.S. generally has supported those geographic trade association efforts. However, the U.S. has been skeptical of preferential market arrangements between geographically separated countries on the grounds that these *ad hoc* arrangements complicate developing country tariff structures and that while they may cause some benficial trade development, their main trade effect more often is trade diversion to higher cost sources.

Among the developing countries, the nations of Latin America and the Caribbean have been the most active in undertaking formation of free trade areas and customs unions. Their efforts at economic integration have produced mixed results, with considerable progress by the Andean Subregional Group within the Latin America Free Trade Area (LAFTA), a standstill within LAFTA itself, and a breakdown and pending reorganization within the Central American Common Market. In the Caribbean, the free trade area (CARIFTA) has recently transformed itself into a common market (CARICOM) by the creation of a common external tariff but the success of this transformation cannot be judged as yet.

In the Middle East and Africa, plans for common markets (among Arab states, East and West African groupings) have generally fallen far short of intended goals, leaving these countries with agreements which have been characterized for the most part by *ad hoc* exchanges of preferences having little impact on regional economic development. However, the East Africa Economic Community (Kenya, Uganda, and Tanzania) continues to function as a customs union along lines established prior to independence. And recently the framework has been worked out for an Economic Community of West African States (ECOWAS) aimed at creating a West African customs union.

In Southeast Asia, a new ASEAN grouping comprised of Indonesia, Malaysia, Singapore, the Philippines, and Thailand shows growing ability to coordinate these countries' approaches to multilateral economic issues. So far, however, there has been no actual move toward the formation of a customs union or free trade area.

D. *Impact of Trade Policy on U.S. National Income, Employment, Wages and Working Conditions.*

The Trade Act aims at lowering trade barriers and promoting open and nondiscriminatory world trade. The basic rationale of the Trade Act is to foster the economic growth of the U.S. through expansion of domestic and foreign commerce. Underlying this rationale is the concept that increased export earnings by the developing countries, aided by GSP and further worldwide trade liberalization through MTN, will result in a direct expansion of their imports of goods and services which can further benefit the U.S. Developing country imports are already an important component of U.S. trade, accounting for 32.1 percent of U.S. exports in 1973.

In addition, the Act does contain safeguards for U.S. industry and labor against unfair or injurious import competition. The provisions of the Act designed to minimize possible adverse effects for the U.S. include:

—assessment by the International Trade Commission as to the probable economic effect of modification of duties on articles also produced by U.S. industries and on consumers;

—requirement that the President reserve from tariff reduction any article subject to safeguard relief, a national security action or any other article he determines import sensitive;

—phasing of tariff reductions to avoid abrupt disruptions;

—requirement of Congressional approval for agreements on nontariff barriers providing an opportunity to assess their impact;

—liberalized access to safeguard relief for industries;

—liberalized program for adjustment assistance for workers, firms and communities through payment benefits, job search and training, loans and loan guarantees; and

—more effective and efficient statutes dealing with unfair trade practices.

Under the MTN, agreements on reducing trade barriers may take several years to negotiate and any measurable effect on the U.S. economy is unlikely to be felt for several years thereafter. While the impact of trade concessions granted under the GSP will be more immediate, since preferences could be extended on products within the year, several years of operation would be required in order to evaluate the domestic effect. However, adequate safeguards are provided to prevent a disruptive effect on the U.S. economy. Before extending preferences, public hearings must be held on articles eligible for duty free entry to gauge the effect of preferences on domestic producers and identify import sensitive products. And, with some exceptions, countries will not receive preferences on articles exported to the U.S. if the total value is in excess of $25 million annually (with some yearly variation on this limit based on GNP levels) or the country has exported a quantity equal to 50 percent or more of the total value imported of that product for the year.