Foreign Aid through Private Initiative

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Report of the Advisory Committee on Private Enterprise in Foreign Aid

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Chairman's Summary

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Advisory Committee on
Private Enterprise in Foreign Aid

Ernest C. Arbuckle, Dean, Graduate School of Business, Stanford University

Joseph A. Beirne, President, Communications Workers of America, AFL-CIO

William T. Golden, Corporate Director and Trustee

Henry T. Heald, President, The Ford Foundation

Kenneth D. Naden, Executive Vice President, National Council of Farmer Cooperatives

Edith Sampson, Judge of the Circuit Court of Cook County, Illinois

Sydney Stein, Jr., Partner, Stein, Roe & Farnham

Arthur K. Watson, Chairman, IBM *World Trade Corporation*

Murray A. Wilson, former President, National Society of Professional Engineers

Here, in brief form, are the findings of the Advisory Committee on Private Enterprise in Foreign Aid. The Committee's full report includes some thirty-three recommendations, and this summary does not detail them all. It does, I believe, outline the main thrust of the Committee's thinking and touches on most of the major recommendations. For a broader understanding of the Committee's thinking, reference should be made to the Report itself.

As Chairman of the Committee I offer this as my own brief statement. I do wish to emphasize that the Report itself is the work of the full Committee which was aided by the cooperation of many others. I am grateful to them all.

Arthur K. Watson
Chairman

Foreign Aid through Private Initiative

Foreign aid, unless it is amplified by private initiative, is doomed to be a costly palliative that will go on indefinitely. The fundamental difficulty lies not in the idea of foreign aid, nor its execution by the Agency for International Development, but in the vast gap between the human and financial resources actually going into the developing nations and the resources they need to grow at an acceptable rate.

In overall terms, the Committee's recommendations are directed to two general areas where government initiative can stimulate the private sector:

> *Capital—Government should seek to stimulate the flow of direct and indirect investment to the developing countries through tax incentives, expanded insurance coverage plus various programs recommended to improve the investment "climate" in these countries.*
>
> *Human resources—Through organizational changes and subsidy,* AID *can tap the vast reservoir of private technical and institutional skills in the United States.*

The capital gap alone has been estimated at between \$5 and \$20 billion annually. Since no conceivable increase in government financed foreign aid is likely to fill all of this gap, the Committee concluded that the private sector must fill it or it will not be filled. Our full panoply of the private sector: business, labor organizations, educational institutions, professional societies and foundations, must be committed more fully to economic development. The Agency for International Development, far more than it does now, must act as an energizer and catalyst for private effort.

United States business' commitment in the less developed countries is extensive. But most of this is in extractive industries and the rate at which Americans are investing fresh capital in the developing countries is modest. Unless investment is deliberately stimulated, the Committee sees no reason to expect this rate to increase very much.

There are reasons, real and imagined, why business today is limiting its commitments in the developing world. For one thing, markets in these countries are small by American standards. To some degree, also, promising opportunities are simply overlooked by American business. The overwhelming reason, however, is that business finds a difficult "climate" for enterprise in the developing world.

Inflation, to greater or lesser degrees, is common to nearly all developing nations. Systems of business law and regulation are outmoded, capital markets are rudimentary, and there is, nearly everywhere, political risk. Legend notwithstanding, alleged high profits are not offsetting these hazards.

Increasing the flow of private capital

Obviously, if business is to augment vastly its investments in the developing countries the odds must change—there must be less risk of loss and greater prospect of profit.

To some degree, the Committee concluded international agreements will help. It recommends that the United States ratify the proposed Convention for Settlement of International Disputes and that it support an investment code under international sponsorship. It

is also urged that AID support large scale feasibility studies and investment promotion programs to interest more American investors in developing country opportunities.

But, the high risk and relatively low profit in the developing countries must also be confronted directly.

To offset the risks, the Committee recommends, among other things, that tax law be amended so that losses suffered by American-owned subsidiaries in developing countries can be offset against profits earned elsewhere. The Committee, in addition, endorsed the tax credit proposal which gives investors a 30 percent credit, applied against U.S. tax liabilities, on investments made in developing countries. This credit would apply to portfolio as well as direct investments.

Of great importance, the Committee also urged that the cost of Selected Risk Guaranties be reduced and that the Extended Risk Guaranty program be greatly expanded. Both types of insurance would be made available to portfolio investors as well as direct investors.

Specific Risk Guaranties insure American owners against three categories of risk; the inconvertibility of currencies (though not devaluation), nationalization and confiscation and losses from war and revolution. Extended Risk Guaranties offer broader coverage and can be used, in fact, to insure investors against nearly all risk. It has been used only cautiously to date.

Guaranties could be a major inducement to business and could, for the first time, enable American institutional lenders to use a portion of the vast sums they manage in the developing economies.

There are, of course, ideological objections to full Guaranties and the very practical objection that they may one day result in large claims against the Treasury. Nevertheless, the Guaranties properly administered are likely, in the judgment of the Committee, to be less costly than alternative means of achieving economic progress and are one of the few tools available that could make a major difference.

Capital is scarce, and interest rates are high in developing countries and long term

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loans, at less than the most elevated rates, are virtually unknown. This impedes the growth of private enterprise, and the Committee believes the situation can be improved.

For one thing, it urges that the Federal Reserve Board recommendations on foreign lending, designed to protect our balance of payments position, not be allowed to penalize the less developed countries. Indications are that U.S. banks, in complying with the Board's recommendations, are not lending as freely as they might in the less developed countries. The Committee believes that development must be given priority over the balance of payment impact. It does not think the impact from loans to less developed nations will be very great.

The less developed countries need a wide range of modern credit institutions, from development banks and credit unions, to underwriters. It is recommended that an international technical assistance program be created to help establish these institutions and train their personnel. American expertise would be useful, but in many instances the experience of countries such as Japan and Mexico, which have successfully established some unorthodox institutions, will be more relevant to the problems of the less developed countries than our own.

To get more capital into private hands in the developing countries, the United States Government is also urged to approve a proposal that would permit the International Finance Corporation to borrow $400 million from the World Bank. At the same time, AID is asked to use more of its surplus local currencies (money earned mostly from the sale of surplus U.S. food) to broaden the capital bases of financial intermediaries in the less developed countries.

Human resources

While capital is scarce in the less developed countries, the more subtle and difficult shortcoming is human and institutional. The most basic problem in the whole development effort is that of transferring skills and technology, and to some degree attitudes, to indi-

viduals and institutions in the less developed countries.

One way to expedite this, the Committee concluded, is to subsidize the export of technical assistance to institutions in the developing countries. The labor union or business receiving the help would pay what would be a reasonable amount by local standards, and AID, through subsidy, would make up the difference.

The Committee also recommends that U.S. exporters of technical and professional services be made eligible for the same financing and guarantying facilities from AID and the Export-Import Bank that exporters of tangible goods now receive.

Special attention was given to the role of agriculture in less developed countries because the race between population and food supply must be won before significant overall development can begin. In many less developed countries, up to 80 percent of all workers are in agriculture. The key to progress in that sector is not only direct transfer of new production techniques, but a judicious combination of new technology, capital transfer, accelerated appropriate public research, and technical assistance in building institutions in the credit, education, health and cooperative marketing and purchasing fields.

While the Committee did not attempt to appraise the operating efficiency of AID, it made several suggestions to better integrate the public and private sectors for more rapid economic development.

For one, it recommended that AID expand its staff of private enterprise professionals in Washington and in the field. It pointed to the need for a new private sector representative within AID. He would be a man of sufficient stature to command the respectful attention of the non-government community and within the AID organization.

The Committee also recommended that proposals for one or more quasi-private organizations for technical assistance be formulated for presentation to Congress next year.

Such institutions, the report suggested, might receive funds from Congress, on contract from AID, from private sources such as foundations, and from foreign governments. They would at the outset perform three specific functions: (1) the administration of technical assistance programs in countries, such as some of the oil-rich nations, which do not receive foreign aid in the usual sense or where AID programs are being terminated but which do need help in the upgrading of their human resources; (2) the exchange of plans and information among United States foundations, universities, professional societies and charitable and religious organizations regarding their activities in the less developed countries; and (3) the maintaining of contacts with non-profit organizations in these countries.

The job of economic development is vast, and at times disheartening. Nevertheless, the Committee believes that our interests are best served by building up the productive capabilities and democratic institutions of the less developed countries. What Americans do demand, and what they are entitled to have, is the assurance that their resources and support are applied with intelligence, skill and dedication.

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Agency for International Development
Washington, D.C., July 1965

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Private Enterprise in Foreign Aid

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Sydney Stein, Jr., Partner, Stein, Roe and Farnham

Murray A. Wilson, former President, National Society of Professional Engineers

Sub-Committee on Investment Guaranties

Chairman, Kenneth A. Lawder, Treasurer, W. R. Grace and Company

Peter B. Langmuir, Vice President, Northwestern Mutual Life Insurance Company

Alfred H. VonKlemperer, Vice President, Morgan Guaranty Trust Company

L. Stanton Williams, Vice President, Pittsburgh Plate Glass Company

Consultant to the Committee

Raymond L. Vernon, Director, Development Advisory Services and Professor of International Trade and Investment, Harvard Business School

Committee Staff

Harriett S. Crowley

Kenneth M. Rabin

Boris Scherbak

Letter of Transmittal

The Honorable David E. Bell, Administrator
Agency for International Development
Department of State

Dear Mr. Bell:

In submitting, herewith, the Report of the Advisory Committee on Private Enterprise in Foreign Aid, there is one principle I would especially like to emphasize. Over the past months, as we worked to relate foreign aid and private initiative, we came to believe that no matter how carefully our aid dollars are invested and no matter how wise and energetic AID's personnel may be, there is still not enough money nor people to accomplish the vast task the U.S. has undertaken.

To put this into perspective, our government is today putting over two billion dollars each year into the economies of 72 countries. Yet this considerable sum, divided among their populations, comes to but $1.44 per person. Even in Latin America, where the effort is most intense, the amount is only $2.73 per person each year. Clearly there are limits to what we can hope to achieve.

It is this realization, more than the original mandate of our Committee, which finally leads us to urge that the Agency for International Development put increasing stress on its role as catalyst and energizer for private effort. It is only through private resources, our own and those of the developing countries themselves, where the additional resources are potentially adequate to meet the challenge. That is the basis of our recommendations.

The Committee is grateful for the help of many people. Over the course of its life, more than a hundred witnesses testified before us, and many individuals and organizations submitted statements to us. We heard from representatives of business and labor, the religious organizations, foundations, educational institutions, agriculture and others. We are especcially grateful to Dr. Raymond Vernon, who helped to draft this report, and to Mr. Kenneth A. Lawder, who headed our Subcommittee on Investment Guaranties.

The very willingness of so many to help persuaded me that Americans from every background believe in the moral and practical values of our foreign aid program. It is one of our country's noblest efforts and I submit this report with the earnest hope that it will further this great effort.

Respectfully submitted,

Arthur K. Watson

Arthur K. Watson, Chairman
July 30, 1965

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Background

The Advisory Committee on Private Enterprise in Foreign Aid was authorized by an amendment to the Foreign Assistance Act of 1963, Section 601(c), introduced by Senator Jacob K. Javits and co-sponsored by Senators Ernest Gruening, Hubert H. Humphrey and Wayne A. Morse.

The legislation called for the establishment of a nine-member group to "carry out studies and make recommendations for achieving the most effective utilization of the private enterprise provisions of this Act . . ." Its members shall represent the public interest . . . and be selected "from the business, labor and professional world, from the universities and foundations, and from among persons with extensive experience in government." The Committee was ordered to submit its report by June 30, 1965, to the Administrator of the Agency for International Development, and to make it available to the President, to Congress, and to the public.

The members were appointed on May 26, 1964, and convened on June 17, 1964. Beginning in September, the Committee held monthly meetings at which it received the views and recommendations of well over a hundred persons and organizations concerned with international development. Contributors to the Committee's work are listed in the Appendix of the Report.

During the life of the Committee, several members visited one or more developing nations of the world to review the present and potential uses of private resources for international development.

Members received no compensation for their services but were entitled to reimbursement in accordance with section 5 of the Administrative Expenses Act, for travel and other expenses incurred in attending meetings.

Section 1:
Private Enterprise and Foreign Aid

This report explores methods for harnessing the vast non-governmental sector of the United States to the task of accelerating economic growth in the less developed countries.

In broadest terms, the Advisory Committee on Private Enterprise in Foreign Aid believes that non-government resources not only can do more, they must. Otherwise, foreign aid would be doomed to become a costly palliative of indefinite duration. The Committee concludes that business, labor organizations, agricultural groups, professional societies, educational institutions, foundations and many other resources, if encouraged, are ready and willing to assume a broader role in international development.

Twenty years have gone by since the United States launched its first post-war program of foreign aid. In that time, some $40 billion of economic aid has been appropriated by the United States Congress; first, to help our friends in Western Europe recover from the destruction of World War II; then, to help the lagging countries of Africa, Asia and Latin America in their long climb out of the depths of poverty.

By and large, foreign aid has achieved a great deal. Yet as one looks back on those twenty years, the programs seem to have presented an uninterrupted series of crises. In the annual Congressional reviews, the program's many remarkable accomplishments often have seemed swamped by accounts of its shortcomings and failures. It is hardly surprising that there is now a widespread desire to question what the United States has achieved for its time and money.

In the perspective of history, however, both the time and the money will seem modest. Twenty years is hardly long enough for a single generation to grow out of a deprived and ignorant childhood. The $40 billion is less than one-half of one percent of the wealth produced by the United States during the period.

The efforts of advanced countries to help less developed nations toward economic growth and political maturity will go on. From time to time, there will be doubts and misgivings about the wisdom or the effectiveness of the effort. Nevertheless, most Americans understand very well that the effort should continue and our political and economic interests are best served by building up the productive capabilities and democratic institutions of the less developed countries. What Americans do demand, and what they are entitled to have, is the assurance that their resources and support are applied with intelligence, skill and dedication.

The Resource Gap

If the less developed countries are to grow at tolerable rates, they will need a great infusion of capital and human skills from the advanced world.

As matters now stand, there is a huge gap between what the less developed countries need for a tolerable rate of growth, and what they are likely to get. As far as their capital needs are concerned, the gap has been measured by various United States and international agencies. Each of these measures is based on somewhat different assumptions and none can be entirely precise. Yet all of them suggest that the size of the gap is staggering—between $5 billion and $20 billion annually.

Part of the reason for this great gap lies in the underdeveloped areas themselves. They are simply unable to absorb large quantities of capital efficiently. For the most part, this is because of a second gap—the gap in human resources. This need is more subtle and, in many ways, more profoundly disturbing than the gap in capital. The less developed countries are critically short of the skills, traditions, and organizations that are part and parcel of a modern industrial society. These lacks run from skills in factory layout to skills in the conduct of management-labor relations; from knowledge about plant breeding and animal raising to knowledge about flood control and weather forecasting; from skills in the mobilization of savings to skills in the distribution of foodstuffs.

The less developed countries lack also the men and institutions to ensure that the fruits of their growth will be fairly distributed. They lack union officials who are capable of bargaining responsibly with management, and tax collectors who are capable of enforcing objectively the tax laws of their countries. In short, most of the complex social and cultural infrastructure which we in the advanced countries take for granted has to be put in place brick by brick. Money alone will not do the job.

In surveying the size and nature of the problem, this Committee has come to three basic conclusions:

First, added capital cannot be expected to come from government sources in quantities sufficient to fill the gap. The non-government resources of the United States and other advanced countries must, therefore, play a much greater part.

Second, the skills and other human resources which the less developed countries need must also come largely from non-government sources. Governments simply do not have command over most of the human resources that are needed.

Third, the role of the non-government groups—of business enterprises, labor unions, professional societies, and all the rest—must be greatly expanded. Otherwise the economic development we do achieve will not provide the pluralism, the democratic balance, and the diffusion of benefits which are its final purpose.

The Means of Assistance

In the course of nearly two centuries of national existence, we Americans have managed to develop a social system which is unique in human history. We have built the world's most powerful economy and, in the course of this growth, have developed institutions on a giant scale. We have the largest enterprises in the world, the biggest labor organizations, the biggest governments, the largest farm complexes, the greatest universities, the largest private charitable and benevolent organizations. At the same time, we have maintained an open society in which economic and political power is widely diffused, in which initiative and innovation can spring up from many levels, and in which barriers between social and economic groups are as insignificant as man has so far been able to devise.

Most Americans see this great diffusion of power and this unparalleled measure of social and economic mobility as prime sources of this country's strength. Yet, from time to time, we feel a sense of impotence and inadequacy as we confront the monolithic discipline of the Communist societies, with their apparent capacity to mobilize all their men, all their technology and all their capital to some single purpose. From time to time, too, we feel at a disadvantage in the face of seemingly coordinated and disciplined actions of other advanced nations in Europe and Japan, which appear to have found a way for the public and the private sectors to move in close harness. As we see other nations face up swiftly to some crisis or some opportunity in international affairs, we sometimes wonder if the United States has yet found the formula for effective operation in the international area.

In theory, the American constitutional system puts the conduct of foreign affairs firmly in the President's hands, yet the economic resources which give him strength are not easily mobilized. In contrast to the monolithic reach of totalitarian states, our own Federal government accounts for about 10 percent of the purchases of goods and services while state and local governments account for another 10 percent. The control of the rest is distributed among millions of farms, hundreds of thousands of business enterprises, and great numbers of non-profit organizations.

United States interests abroad are almost as greatly dispersed. An estimated 3,000 United States businesses have facilities abroad. More than 500 educational, labor, charitable and religious organizations have programs or facilities overseas. Each of these in its own special way represents a part of our American system; but few of them are responsive to any common purpose or common strategy.

As it turns out, some of the resources that are needed by the less developed countries lie within the ambit of the Federal Government; but a critical part of those resources lie beyond government's reach. The Federal Government may be able to provide some of the capital funds; but it needs the participation of other sectors of the American economy in providing the skills to design a plant, organize a market, train a work force, raise a crop, or distribute a commodity. The Federal Government has no command authority over the skills of a university, a foundation, or a labor union. Accordingly, a well-balanced strategy of assistance to less developed nations must contemplate that there will be a role for all sectors of the United States economy. If the environment is right, some of these sectors will move into such activities as a normal part of their own operations. Many already have. Others, however, will have to be encouraged, persuaded or assisted to extend their activities to the less developed countries.

In sorting out the respective roles of the private and the public sectors in providing the resources for the aid program, this Committee believes that there are a few basic guidelines to be followed, guidelines which are derived from the experience and the convictions of the American people.

In the first place, private organizations are generally capable of greater speed, flexibility and incisiveness than government agencies. Freed from government procedures, permitted to find their own ways of performing the tasks which are necessary for economic growth, private organizations can outperform official agencies. These comparative strengths are no reflection upon the men and women who man our government posts; on the contrary, our experience as members of the Committee has left strong, favorable impressions of the energy, dedication and good sense of the AID leadership.

In part, the limitations of AID are due to the fact that it represents simply one part of a complex government machine which has many objectives apart from development. In individual cases, therefore, the development objectives may be pitted against conflicting government aims. In part, too, the limitations of AID simply derive from the fact that, under the U.S.

system of public checks and balances, the program is subject to continuous scrutiny from many directions: from the press, from Congress, from other government agencies. The result is sometimes deeply frustrating. It usually takes many months for AID to comply with the statutory requirements for employing technicians or consultants, or for processing contracts, loans or guaranties. There are exceptional cases. An emergency can generate faster action through extraordinary channels. But the use of extraordinary channels carries extraordinary risks for the government agency involved.

The Committee has been guided by *a second general point,* which also favors the more extended use of non-government channels in the aid program. There is always a risk that government-to-government aid may be mishandled. When this happens, both governments are exposed to special political risks. Such aid at times can generate a backwash of bitterness and resentment. Aid through private channels carries fewer risks of this sort.

A third general guideline by which this Committee has been influenced relates to the limitations of American private organizations. Though private entities may be free to react more quickly and flexibly, they operate with certain constraints of their own. Like all American institutions, they should be expected to make sacrifices to common national objectives. But there are limitations on the extent to which most private organizations can take on extraordinary financial risks. The existence of such organizations depends upon their ability to remain strong. This overriding fact cannot be disregarded by their managers.

There is still *a fourth guideline* which the Committee has found useful in its deliberations. Much of the work to be pursued under the foreign aid program, as we noted earlier, is intended to train people, to speed changes in institutions and values. Tasks of this sort take time, a great deal of time. They require prolonged, continuous contact from the aid-giving end. Yet without fixity of purpose and involvement of vital self-interest, such continuity is usually in constant peril. In its application, this fourth guideline can mean different things for different programs. In many cases, it argues for a transfer into private hands of activities now performed by government agencies. Pushed and hauled by the vagaries of public and Congressional sentiment, by the limitations of the annual appropriation process, and by the changing tactical concepts of successive administrations, government aid agencies cannot be expected to demonstrate constancy of purpose as their outstanding attribute. Accordingly, competent and stable private institutions may be far more effective instruments of national policy in some situations than government institutions.

A fifth guideline which has influenced the Committee's conclusions is the principle that public resources wisely used can attract private resources in even greater quantities. There are many illustrations in our national life in which public resources have been used as catalysts and energizers of the much greater sources available to the private sector. By providing such indispensably basic facilities as transportation and education, by clearing away obstructing bottlenecks, by reducing the risk and uncertainty of the political and economic environment, by providing some element in an undertaking which the private sector is unable by its own efforts to provide, a public foreign aid program can "leverage" its total impact many times.

The Means of Receiving

We in the United States see our nation as a symbol of the vitality and creativeness of a pluralistic society. We have not yet stamped out the last traces of poverty and prejudice in our economy. But what has been achieved so far gives Americans every reason to champion the role of private initiative and stress the importance of freedom of opportunity.

True to its history, the United States has urged the less developed countries to strengthen and extend their own private sectors and to build up many of the other institutions of a pluralistic society, such as trade associations, labor unions, family farms, cooperatives and foundations, as a critical step in the achievement of economic and political maturity. At the same time, we have come to learn that there are fundamental cultural and historical differences and important differences in priorities which distinguish the advanced countries from those in the less developed world.

The extent of some of the differences that have to be bridged is indicated by the reaction of some countries to the concept of private enterprise. To the countries of Asia and Africa which are just emerging from centuries of colonial rule, the words "private enterprise" conjure up a series of images and associations which are as different from the familiar United States connotation as night is from day. The outstanding examples of "private enterprise" in the colonial economies were usually enterprises controlled from the mother country, often with privileged status. In the heat and tension of the struggle for freedom, therefore, "private enterprise" is seen by many Asians and Africans as part and parcel of a system of domination from without; and the United States espousal of "private enterprise," especially foreign-owned private enterprise, is seen by many as a Trojan horse intended to impose a new form of political and economic bondage upon them. Although colonialism has long ceased to be a problem in most of Latin America, many nations in that area of the world tend to echo the reactions of the Asians and the Africans.

In addition, all underdeveloped countries express concern over other aspects of foreign private investment. Rightly or wrongly, they worry about the balance of payments impact of servicing a growing foreign interest. And they want to know how they can remain masters of their own house if foreigners control their principal means of production.

In most parts of the less developed world, therefore, local sentiment is torn between two conflicting views. On the one hand, they recognize that private enterprise can make great contributions to the development process. On the other hand, there is a fear of its bigness and of dominance by such enterprise. Of course, one would expect those local groups which are politically hostile to the private enterprise system to be hostile to foreign-owned business. But the same antagonistic reaction is also found among those who have a stake in the private system. In many countries, local businessmen see foreign-owned business as a giant "unfair" competitor, not as a helpful ideological ally.

The United States, therefore, confronts a less developed world in which private enterprise is often on the defensive. Indeed, it faces a world in which some nations profess to be evolving toward one form or another of socialism. Nevertheless, paradoxically, the future of the private sector in the less developed world is far from discouraging.

The experience of India is illustrative. In the execution of each of the three Indian Five Year Plans since 1951, the private sector has responded more dynamically and the public sector less dynamically than the Plan had projected. As a result, each successive Plan has assigned a larger role to the private sector than its predecessor Plan. In the process, doctrinaire Indian declarations on the subject of state socialism have given way to more balanced and more pragmatic evaluations of the respective roles of the private and public sectors.

The trend in other countries, such as Mexico and Pakistan, has been in a similar direction. In these countries, and in many others, a modern, dynamic private sector has evolved with unexpected speed. While the old cliches about "exploitation" continue to have great currency in these countries, there is at the same time a widespread recognition that many of the new entrepreneurs simply do not fit the old patterns. As a result, government servants are more disposed to accept the desirability of linking the freedom and flexibility of the private sector with the power and purpose of the public sector. At the same time, noting some of the unhappy consequences of state ownership in Egypt, Guinea, Ghana and other countries, various governments in Africa, Latin America and Asia have felt even more strongly the need to modify their doctrinaire socialist views.

In some ways, the experience of the less developed countries in the field of agriculture has also suggested a bigger role in the future for the private sector. The problems of agriculture have been more perplexing, and more threatening to the aspirations of the less developed countries than the problems of industry. In many cases, these countries have been unable to raise their farm output to match the increase in their population. The reasons have been complex and they have differed from country to country. Sometimes, the problems have been rooted in predatory forms of land tenancy, money lending and monopoly marketing which have deprived farmers of any incentive to increase output. Sometimes there has been a need for greater public investment in roads, drainage, water or power. Sometimes, the need has been for new seed and technology.

The first response of governments in the less developed countries, notably in India and Pakistan, had been to assume that the government itself would solve the problem through a combination of investment, coercion, and regulation. Today, however, it is rapidly beginning to be clear that the problem can only be met if it also engages the energies of many non-governmental institutions—of private producers and sellers of seed and insecticide, producing and marketing cooperatives, banks, credit unions, and research institutes and testing stations. We begin to see new hope that these countries, by drawing on all their energy and resources, may yet solve the stubborn problem of agriculture.

Nevertheless, as matters stand today, the question of the future roles of the public and the private sectors in less developed countries is uncertain and undecided. Thus far, private enterprise is the dominant form in most less developed countries, including many which profess to some form of socialism. Indeed, in most of these countries, the revenues and expenditures of the public sector are far less important in relation to the nation's income than the levels that typically prevail in Western Europe and North America.

In due course, the less developed nations will generate their own patterns of public-private relationships. When they do, these patterns will bear the stamp of their own history and aspirations. In most less developed countries, the role of national planning will be a good deal stronger than the role to which we in the United States are accustomed. Most of these countries will be less disposed than the United States to acknowledge the innate desirability of private over public enterprise. Mixed private-public enterprise will no doubt be much more common than in our own experience. In many of these countries, the public regulation of private enterprise will continue long traditions, so contrary to our own, of being pervasive, detailed, and of leaving large areas of discretion in the hands of government officials.

We Americans are not without influence in affecting these attitudes. In fact, our influence is often far greater than we suppose. True to our own convictions, we should use our influence as we can. At every opportunity, we ought to broaden and strengthen the private sector. But we must be prepared to accept the fact that the most effective pressures are often achieved through quiet diplomacy rather than through stentorian ultimatums. Indeed, the most effective pressure of all, in the end, is to help increase the resources and capabilities of the private sector so that it may provide its own justification for an expanded role.

One final point. Even a society in which private enterprise is dominant, in which economic power is diffused, and in which checks and balances are basic to the system will need a public sector which has foresight, rationality and planning capacity. In a nation trying to grow under forced draft, that need will be particularly great. To be sure, an economy based on diffused initiative cannot be either highly disciplined or readily predictable. In such a society, it is the function of many institutions to take on new initiatives that may not be according to plan, and to resist the efforts of others which may run counter to their interests. Economies of this sort, when they are successful, grow partly out of the foresight and planning and partly out of the competition and conciliation of the institutions that make them up.

In our efforts to achieve societies of this sort abroad, therefore, we must be prepared to accept the appearance of certain seeming contradictions in our efforts. We must be prepared not only to encourage the growth of private enterprise but also to encourage other institutions with which such enterprise will sometimes cooperate, somtimes clash, for example: an effective structure of government organizations, a creative and responsible structure for the conduct of labor relations, an efficient system of cooperative organizations where such organizations are appropriate, and a series of institutions devoted to educational, philanthropic, and other non-profit activities. It is out of such a ferment that economic growth and the democratic process may be expected to appear.

Section 2: The Flow of Direct Investment

Of the many roles that United States private enterprise is equipped to play in the less developed countries of the world, that of investing in and managing branches, subsidiaries or affiliate companies is the most obvious. U.S. business already has large investments of this sort outstanding in the less developed countries. By early 1964, its direct investment in these areas was $13.3 billion; of this total, $2.5 billion was in manufacturing, $7.5 billion in petroleum and mining, and $3.3 billion in other branches of business activity.

Compared with the needs and possibilities of the developing nations, however, the rate of increase in such investment has been insignificant. Here and there, to be sure, some special circumstance has generated a spurt of investment by United States enterprises. But the total increase of all direct investment by United States enterprises in the less developed areas was only $522 million for 1964. This contrasts sharply with the $5-$20 billion annual gap cited earlier. Most of this increase in direct investment was in the more advanced parts of the less developed world, especially in Latin America; and roughly 20 percent was financed by ploughing back profits previously generated in the less developed countries rather than by a fresh flow of resources from the United States.

The Problem of Climate

Why is so little private investment moving into the less developed countries? Businessmen would answer the question in different terms, but their answers would add to misgivings about "climate."

"Climate" seems a vague word. But it suggests the nature of the concern well enough. United States businessmen are accustomed to evaluating and accepting normal business risks. Not many of them are accustomed to evaluating and accepting political instability, threats and rumors of expropriation, systems of pervasive discretionary regulation, prospects of rapid inflation and devaluation, and other novel features of overseas investment.

Accordingly, the characteristic reaction of businessmen who have sensed the unfamiliar risks posed by the less developed world has been to turn elsewhere for opportunities. This is not to imply that once the climate were improved, all the conditions to attract foreign direct investment would be satisfied. A favorable climate must be thought of as being a necessary, but not a sufficient, condition for attracting foreign investment. The improvement of climate therefore, is only a first step in persuading businessmen to investigate the many opportunities in the less developed world.

Just as the word climate itself is vague in this context, so the means for its improvement in any country are also ill defined. If the threats of inflation and devaluation could be reduced, if the uncertainties of political life could be contained, if the latent and active hostility against foreign owned enterprise could be held in check, climate would be improved. But these are symptoms of the basic problems of underdevelopment itself.

There are no simple nostrums for the improvement of a country's climate. Confidence cannot be guaranteed, for instance, simply by extracting a declaration in favor of private foreign investment from an aid-receiving country, if any duress is involved in the process. On the contrary, in some cases, commitments of this sort when extracted as a condition of foreign aid, may imperil a friendly government and expose foreign investment to needless risk.

Though the measures needed to improve a nation's climate may not be crystal clear, it is clear that in any such effort nothing succeeds quite like success. If a less developed country succeeds by its policies in attracting some capital, this in itself is the largest single step that the country can take to attract more capital. The stimulating effect of capital at work bolsters confidence and expectation.

There are countries, however, which are on dead center in this regard. With confidence impaired, the question is how to build back the climate to a point at which businessmen will be prepared to consider opportunities in such countries again. In a succeeding part of this section, we shall have various proposals to that end, including tax and guaranty proposals. But some general measures may be helpful.

AID has been supporting a number of programs aimed at increasing the degree of local understanding of a privately-oriented economy. In some cases, AID is using its influence to point out that existing legal and regulatory structures are unnecessarily discouraging to business, both local and foreign. In other cases, schools of business administration receive support; in others, systematic contacts between private organizations are being financed; and in still others, selected individuals visit the United States to see for themselves how a complex privately-oriented system such as the United States actually works.

As the Committee observed in Section 1. the climate for operations by foreign and local private organizations has improved recently in a number of major countries of the less developed world, such as India and Brazil. There remain many opportunities to link AID's work on the improvement of climate with the thoughtful and imaginative work which various business groups and foundations are undertaking on their own initiative. Recent programs sponsored by private groups in Turkey, Mexico, India and other countries afford businessmen and government officials unprecedented opportunities to explore their common interests and reconcile their conflicts. More effective coordination of AID and non-governmental efforts of this sort could increase their total effectiveness. Accordingly:

> *We recommend that* AID *select a number of key aid-receiving countries for intensive study of factors which may improve the investment climate; that such studies enlist the help and advice of the appropriate business communities concerned; that an explicit program be developed for the improvement of the climate in those countries studied; and that, wherever the foreign aid program offers some effective opportunity for the improvement of such climate, the opportunity be used to the full.*

Even as it makes this recommendation, the Committee is aware that AID's capacity to use the foreign aid program as leverage is limited in many ways. International agencies, such as the World Bank or the International Monetary Fund can, at times, be much less inhibited in trying to induce constructive change. To be sure, the fact that the United States is ready to provide added resources to a country which has made its peace with the international agencies may be an important reason for the influence of those agencies; but the fact remains that such agencies are at times in a better position to induce change. Accordingly, the Committee is pleased to note that international organizations such as the Organization for Economic Cooperation and Development (OECD) and the World Bank are developing various proposals which could improve the treatment of foreign private investors.

One such initiative is the development by the World Bank of an International Convention for the Settlement of Investment Disputes, recently submitted to nations for ratification. The Convention sets up conciliation and arbitration machinery which foreign investors and contracting states are free to use in the settlement of investment disputes. The Committee regards this approach as highly desirable. Accordingly:

> *We recommend that the United States Government accept in principle the concept of international arbitration; that it ratify the proposed International Convention for the Settlement of Investment Disputes; and that it seek to secure its ratification by others.*

Another international initiative of great potential interest to the United States would be an international code for the fair treatment of private foreign investors. Other efforts of this kind have floundered in the past, under the pressure of the representatives of the less developed countries, which have felt obliged to try to match the "obligations" of the host countries with the "obligations" of the investors themselves in any such treaty.

While some of the counter-proposals may be objectionable, others are perfectly appropriate. If the "obligations" proposed by the less developed countries are reasonable, we believe that United States subsidiaries will find them tolerable and will appreciate the opportunity to demonstrate what modern constructive private enterprise can achieve. Indeed, American owned businesses in the less developed countries typically lead in such matters as wages, working conditions, in-service training programs, and tax probity. A declared willingness to continue such standards can only bolster the position of United States enterprise and strengthen the general cause of the private sector abroad. Accordingly:

> *We recommend that the United States Government lend its full support to the principle of an investment code under international sponsorship; and that as part of such a code the United States be prepared to accept a reasonable statement of the obligations of investors, to accompany a statement of the obligations of host countries.*

The Committee recognizes that international agreements alone offer no final guarantee for the hesitant investor. The purpose of such agreements is only to contribute toward meeting the profound need for a psychologically improved climate. The advantages to a less developed country in adhering to such codes have to be obvious and substantial. The elite status of the less developed countries which are signatory to the code has to be widely recognized.

The Initiating Investment Force

It is a long tortuous path from the faint gleam of some investment opportunity in a far-off country to the consummation of the investment.

The first step on the path is to engage the attention of the investor sufficiently so that he is prepared to investigate the possibility. This is not easily achieved. It costs money to explore any proposal for an investment in a foreign enterprise; perhaps more important, it costs the time of key corporate officials whose attention could otherwise be engaged in larger and more familiar issues close to the heart of the enterprise's immediate interest.

Of course, a few enterprises are fully geared to deal with problems of this sort and the number of such companies is increasing. These companies systematically scan world markets and world raw material sources for opportunities to invest. They systematically compare costs, appraise the quality and temper of the labor market and of labor organizations, estimate the future policies of governments, and try to come to some net judgments concerning investment prospects. But the number of such companies is still fairly small. More typically, the interest of United States companies in overseas investments is sporadic or nonexistent; and where it exists, it is confined to a few of the more familiar, more developed areas of the world, notably Canada and Western Europe.

If the prospective investor is unfamiliar with the circumstances within a given country, the chances are slight that he will go very far out of his way to develop the necessary knowledge. If he does investigate, it is likely to be only in response to the strongest sort of stimulus. If no direct interest of the prospective investor is involved, an exceedingly persuasive well-documented case, presented under favorable auspices, may generate the necessary follow-up. But casual, run-of-the-mill contacts are unlikely to yield any response.

All this is familiar ground. The lessons are well known to the authorities of those few countries and areas that have successfully promoted private direct investment in the past, such as Israel and Puerto Rico. In both these cases, government agencies have set up an elaborate machinery to generate feasibility studies in detail, to "sell" the opportunities suggested by these studies to individual business organizations in the United States, and to guide the hesitant investor over the innumerable hurdles involved in setting up a new undertaking.

An appreciation of the importance of this kind of effort has been evident for some time in the AID activities. In recognition of the problem, for instance, AID and the Department of Commerce have undertaken a number of different programs.

First, the United States Government, in certain cases, will finance up to 50 percent of the cost of pre-investment surveys undertaken by United States investors; by April 1965, it had in fact authorized 126 such studies. Second, AID has financed a certain amount of technical assistance to industrial banks in the less developed countries, in order to expand their capabilities in making feasibility studies.

Third, AID has financed the publication and distribution of a Catalogue of Investment Information and Opportunities. Finally, the Department of Commerce, in cooperation with AID has created an Office of International Investment to bring investment opportunities to the attention of the business community.

Our impression of these programs so far is that they are neither adequately designed nor staffed to create new investor interest. The assistance in financing feasibility studies to the United States investor has been relevant only when an active interest in a project already existed. It has not been especially helpful to the long process of creating investment interest where none previously existed. As for feasibility studies not involving a United States investor, these have more often been financed for the public sector than for the private sector. This does not reflect any conscious bias on the part of AID. It may be the result of a tendency to stress the large, individual, identifiable project at the expense of the smaller one and a tendency to finance the exploration of projects already half-conceived at the expense of more general surveys.

The studies required to stimulate private investment interests often differ markedly in emphasis from those required for the large individual project. National surveys of market potential, market distribution channels, or investment opportunities may be a first necessary step. Analyses of legal and institutional impediments to the creation of industries may also be required. The feasibility of specific individual projects might be considered only at a second stage. And the "sale" of such projects abroad might be a third important stage, separable from the other two. This suggests introducing a considerable degree of flexibility into the financing of investment-promoting studies in order to cover an area much wider than that ordinarily understood in a "feasibility" study program. Accordingly:

> *We recommend that both the United States Government and private organizations assist the less developed countries in undertaking large scale programs of market studies and feasibility studies, to be used as part of a campaign in engaging the interest of prospective local and foreign private investors. In view of the need for persistence and continuity in the promotion of any given project, the generating of such studies should be the prime responsibility of local entities, such as a development bank or well-equipped ministry, motivated and equipped to maintain a follow-up campaign from the stimulation of an initial interest by investors to the final act of establishment. If necessary, the contracting of foreign technical assistance should be included.* AID *financing should be predicated on significant contributions by the local institutions but might include the costs of a substantial effort to "sell" proposals in face-to-face contracts with enterprises in the United States.*

The Guaranty Programs

Once the interest of a prospective investor has been engaged, a long process still remains in which the investor ordinarily looks for ways and means to overcome his hesitation and minimize his risks. At this point the various guaranty programs of AID come into play. These programs, the Committee is convinced, have had a significant impact upon the rate of United States direct investment in the less developed areas.

For nearly two decades, AID and its predecessor agencies have had the authority to guaranty United States individuals or business entities and their wholly-owned foreign subsidiaries against certain kinds of risk. By 1964, insurable risks were limited by law to situations in the less developed areas, including those commonly called specific risks: (1) inconvertibility of earnings or of repayment of principal, (2) losses due to expropriation or confiscation, (3) losses due to war or revolution; and those known as extended risk: (4) losses on loans made for housing mortgages, (5) up to 75 percent of the loss on an investment arising out of any such other kind of risk as the President might determine. Different statutory and administrative conditions apply with respect to the various kinds of guaranties; different ceilings control the total guaranties in the various categories. But, by and large, the United States had accumulated a considerable body of experience in guarantying against risk to overseas investment. By the end of 1964, nearly 1000 specific risk guaranty contracts were outstanding on investments in the less developed countries covering risks in the first three categories listed above; and the aggregate of the guaranties on such investments totalled nearly $2 billion.

In addition, there were various signs that the interest of American business in the guaranty program was accelerating. The number of applications for guaranties in the first three categories received by AID in Fiscal Years 1963 and 1964 amounted to 590 and 712, respectively; these figures were higher than those in previous years. The amount of these guaranties issued in FY 1964 was $524.5 million, far higher than in any earlier year and is approximately $800 million for FY 1965.

These three types of guaranty are therefore mature, well-established programs with a history of usefulness and success. For that reason, the Committee is of the view that the time has come to relax some of the statutory and administrative constraints originally applied to such guaranties, in order that they can be applied more widely and less equivocally. Among such measures:

> *We support the proposals under consideration by the Congress which would: (1) raise the $2.5 billion statutory ceiling on the guaranties against inconvertibility, expropriation and military hazards to a new level of $5.0 billion; (2) relax the statutory requirements for enterprises eligible for guaranty, to permit the coverage of*

foreign corporations jointly owned by more than one U.S. company; (3) relax the 20-year statutory limitation on the life of guaranties; and (4) permit AID *to use income from the guaranty program not only for the management and custody of assets but also for certain other operational costs associated with the guaranty program.*

We urge in addition (5) that enterprises be permitted to insure comprehensively for all three categories of risk, rather than for each risk separately, thereby reducing the total amount of insurance coverage required; and (6) that consideration be given to a reduction in the rates applicable to such insurance so that the coverage of two specific risks costs ¾% rather than 1%, and the coverage of three specific rists costs 1% rather than 1½%.

In the case of the housing and extended risk guaranty provisions, experience under the law is a good deal more limited. By June 1, 1965, housing guaranties totalled only $121.3 million and only three contracts had been signed under the extended risk guaranty.

The early caution exercised by AID in administering extended risk guaranty authority is understandable, especially in cases where the business commitment involves a direct investment (that is, an investment coupled with management and control). Businessmen managing the enterprises in which they invest cannot expect to be protected from all the hazards of their operation. Nevertheless, the Committee believes that a really significant potential may be in the extended risk idea. Through it we see a way to make investment in less developed economies attractive, or in many cases even legally possible, for many United States institutional lenders. The Committee recognizes that such insurance may one day result in large claims against the U.S. Treasury. It accepts this as preferable to alternative ways in which development can be stimulated. Accordingly:

We recommend an expansion of the extended risk guaranty. In undertakings in which businessmen are willing to risk as much as 25% of the total investment on a junior basis, an amount not to exceed 75% of the investment should be eligible, upon approval by AID, *for a 100% extended risk guaranty. To permit adequate opportunity for the development of such programs, we recommend that the statutory authority to issue housing and extended risk guaranties be prolonged to June 30, 1969. We recommend also that the $25 million guaranty limit in connection with loans and the $10 million limit in connection with other investments be removed.*

It is well to note that some of the more common risks of business investment in the less developed countries are not covered by existing guaranty programs. The most obvious of these is the possibility of a devaluation of the currency. Concern over devaluation has probably been the largest single source of worry to prospective and committed foreign investors.

There are various ways of reducing the devaluation threat. If an investment is in the form of debt, the debt can be denominated in dollars or other hard currency. Hedges of one sort or another are also possible. But none of these devices covers all the major forms of investment; and some of them are exceedingly costly to maintain.

The concern over the effects of devaluation is particularly important because the reaction of local and foreign investors to that fear can sometimes imperil the stability of the economy of a less developed country. From time to time, a wave of capital flight may seize a country, accompanied by money stringency within the economy and foreign exchange instability without.

This is a well known problem—so well known, in fact, that on the whole its effects are exaggerated rather than otherwise. The oft-repeated guess that capital flight from Latin America in recent years has approximated $10 billion, for instance, is patently without any statistical foundation and probably grossly wide of the mark. Yet the problem is real. The obvious "solutions" to the problem, such as governmental control over capital movements, usually suffer from major drawbacks of a practical kind.

One possibility which has been proposed, however, seems to the Committee to offer sufficient promise to warrant further development. This is the generation of a guaranty fund by the less developed countries, which would permit them to offer external guaranties of indemnity against the impairment of value resulting from devaluation. Obviously, such a guaranty could not be broadly extended in any economy. But it might be possible to conceive of a guaranty applicable to the working funds of key enterprises. Such a guaranty might conceivably reduce inventory hoarding, mitigate the drain on working capital funds, and dampen capital flight when devaluation threatened.

Many operating aspects of such a guaranty would be novel and difficult. In the first place, if the guaranty is to mitigate capital flights, it would have to apply not only to foreign-owned investments but to locally-owned investments as well. In the second place, if the guarantying institution is to offer a credible guaranty, it would probably have to be operated as an international one and maintain some reserves outside the less developed countries.

Finally, the question of the size of loss generated by a devaluation would need to be carefully defined. For instance, the normal net working capital of the enterprise and debt denominated in non-local currency would almost certainly be included in such losses, the undepreciated portion of fixed assets almost certainly would not. To carry these possibilities further:

We recommend that the United States Government urge the World Bank and the Inter-American Development Bank to explore further the feasibility of setting up a guaranty system which would selectively indemnify both locally-owned and foreign-owned enterprises in the less developed countries against the effect of a devaluation.

The Conditions of Entry

After a businessman is persuaded that opportunity exists and risks are tolerable, he has still to establish many remaining conditions of entry.

Most less developed countries have various laws aimed at either encouraging or regulating new investment. As a result, one major phase of the process of direct investment is detailed and protracted negotiation with officials of the host country over the terms of entry. Although businessmen often wish that this step could be avoided or compressed, the stimulus for negotiation usually comes from both sides rather than from the government alone.

In such negotiations, the prospective investor often seeks concessions such as: a guaranty on the right to withdraw profits or capital; a waiver of tariffs or import prohibitions on machinery and raw materials; a waiver of taxes on income; a promise of protection from competing foreign imports; a guaranty that work permits will be issued to foreign managers and technicians associated with the enterprises; or an understanding that the government will provide local transportation, power, land or capital at preferential rates. Governments for their part are likely to demand: employment of local managerial and technical personnel; purchase of local materials; sale of some of the equity in the enterprise to local interests.

One could hope that the less developed countries might move toward a system of law and a pattern of administration in which conditions of this sort were codified and applied on a non-discriminatory basis. On the whole, we believe that movement in this direction, by removing some of the initial uncertainties confronting the private investor, would tend to stimulate such investment. The Committee is content to note the point, and to express the hope that AID will bear it fully in mind in any subsequent efforts to improve the investment climate.

Of the various provisions which are negotiated at the time of entry of new investment, few create as much difficulty as the insistence of many less developed countries that local partners should be taken into the enterprise. There are a number of reasons why governments in the less developed countries often insist on local partners. One reason has been suggested already: the fear that the foreign-owned enterprise may exercise an undue measure of control over the economic life of the vidual case, the fear of being vulnerable to domestic criticism country. Even if a government has no real concern in an indimay lead it to insist upon some degree of local ownership. A second reason for concern on the part of local governments is the fear of a future balance of payments drain in the servicing of a large foreign investment in the country. As local governments see it, foreign investments grow largely on the basis of reinvestment of local earnings and of local bank borrowings. But as they grow, the potential drain through dividend remission continues to swell. To be sure, the full balance of payments effects of any given foreign investment are difficult to measure. It is not surprising that local governments try to mitigate those effects by insisting on some measure of local ownership.

On the other hand, there are perfectly good reasons why some enterprises should find it necessary to resist demands of this sort. The partners in any joint venture do not always have parallel interests. Conflicts can arise over pricing the machinery and industrial materials expected to come from the United States parent, over the assignment of markets by the parent to its different subsidiaries, or over dividend policy and reinvestment policy.

It is no great wonder that many direct investments are abandoned over the thorny issue of joint ownership. Nor does the Committee see any easy way out of the dilemma. A few firms have been known to generate industrial projects in some less developed areas, with either the unilateral intention or the express commitment to sell out their equity interests to local owners within a limited period of time. Occasionally, foreign firms have undertaken to manage enterprises on a fee basis without equity commitments. Some firms have been persuaded to take on local partners, provided the local partners were either firm employees, small public stockholders or a reliable local investment banking institution; some of the recommendations proposed below may help to the extent that they contribute to broadening capital markets and financial intermediaries in the less developed countries.

These approaches, however, are likely to be quite unattractive to many, perhaps most, foreign business enterprises. And for many of these—for good reasons—the wholly-owned subsidiary may be the only acceptable approach. A realistic identification of an issue is sometimes a necessary prelude to its solution. The Committee hopes that this review will contribute to that end. Therefore:

> *We recommend that the United States Government support both wholly-owned and jointly-owned enterprises in the less developed countries, and that it avoid any doctrinaire position on the issue.*
>
> *We recommend further that where the prospective investor has legitimate concerns regarding the nature of the arrangement proposed by the host government, and wishes to enlist the support of the United States Government in expressing these concerns to a host government,*

the United States Government should consider sympathetically the possibility of lending such support.

The Taxation of Income

It is axiomatic that any measure which increases the prospective yield on an investment increases the investor's inclination to make the investment. As a result, there have been numerous proposals to stimulate investment in the less developed areas by reducing the tax burden on the income from such ventures.

To appreciate the import of some of these proposals, a brief description of the existing system is needed.

As a rule, United States taxpayers are not subject to taxation on profits earned by a foreign subsidiary until those profits are brought home to the United States. To be sure, there are some important limitations on this general rule. For instance, profits earned in overseas branches of a United States corporation, as distinguished from an overseas subsidiary, are ordinarily taxable from the moment they are earned. Certain profits paid as dividends by subsidiaries to foreign-based holding companies also may be subject to United States taxation before the profits are brought home. But the general principle remains that overseas profits are not taxable until brought back to the United States.

When the income does become taxable under United States law, the taxpayer is given a credit for income taxes that may have been paid to a foreign government on the same income. The calculation of the tax credit is a complicated business, but its intended effect is to ensure that the total of foreign and United States income taxes levied against a dollar of income will not exceed the regular United States corporate tax rate; unless, of course, a higher rate has already been levied in the foreign country, in which case that higher rate fixes the ceiling.

At various points in this complex procedure, United States law and regulations make important distinctions in the treatment of foreign income, depending on whether the income originates in the less developed countries or in other foreign countries. In general, these distinctions favor the less developed countries. For instance, the formula for calculating the United States tax credit discriminates in certain cases in favor of investments in less developed areas; in those cases, the total tax paid by the investor is less than he would pay on the same amount of income if it arose elsewhere, such as in the United Kingdom or even in the United States proper. Furthermore, United States tax rules about the taxability of income received by foreign holding companies are more lenient if the income is used for reinvestment in less developed countries than for other purposes.

In approaching the problem of tax concessions as a means for stimulating investment in the less developed areas, one has to recognize that tax considerations are only a part of the problem. An investor who considers a new undertaking in a less developed country ordinarily has only the most approximate notions about the size of the market, the costs of production, the prospects of competition, or the difficulties of operation.

Accordingly, there is a strong tendency to decide these investments on the basis of two kinds of questions. First, what is the chance that the investment, once made, may be lost? Second, what is the risk that failure to invest may undermine the investor's long-run position in an important market?

In examining the many proposals for tax relief to investments in less developed countries, therefore, the Committe has considered of great importance those tax measures which deal with the contingency of income loss. The Committee regards this problem as important for other reasons as well. When United States enterprises operate subsidiary undertakings in the United States, they can offset losses in such subsidiaries against gains in their other operations. When the subsidiary venture is located abroad, however, United States enterprises as a general rule are prevented by our tax laws from offsetting foreign losses against domestic gains. Accordingly:

> *We recommend that the United States tax laws and regulations be amended so that the United States taxpayer's right to offset losses in subsidiaries against taxable income from other sources would be the same for subsidiaries in less developed countries as it is for subsidiaries in the United States.*

There are a number of other aspects of United States tax law which appear to operate to the relative disadvantage of investment in the less developed areas. In 1962, United States tax law was amended to grant United States firms a 7 percent income tax credit on added plant and machinery investments; but under the law, plant and machinery to be used outside the United States ordinarily does not qualify. Since then, an agreement has been signed with Thailand, to be submitted to the Senate, which provides among other things for application of a 7 percent credit to United States taxpayers' purchases of plant and equipment for use in Thailand. A similar agreement has been reached, in principle, with Israel; and the subject will be considered in current negotiations with India.

In principle, the Committee thinks it is desirable to remove any provision that penalizes investment in the less developed countries. Accordingly:

> *We recommend that the United States Senate accept the provisions of the United States-Thailand tax treaty which would apply a 7 percent investment credit to United States-owned investment in Thailand.*
>
> *We recommend also that the United States Government*

take steps to apply the same treatment to investment in other selected less developed countries, either by legislation or by treaty.

Among the boldest of the tax proposals to stimulate United States investment in the less developed areas is one which would allow the United States taxpayer to reduce his total tax bill in the United States by an amount equal to 30 percent of certain investments made in a less developed country. (The credit would apply also to reinvestment of profits, to the extent that the reinvestment exceeded half of the profits.) In effect, so long as the United States taxpayer had taxable income, whatever the source of that income might be, he could arrange to be repaid for 30 percent of the investment in a less developed country out of credits granted against his United States tax bill.

The Committee is well aware that discriminatory tax devices must be employed only sparingly as a means to achieve national ends. In this case, however, we see a compelling need to increase the flow of private investment to the less developed countries. This need, in the Committee's view (with one member dissenting), justifies special measures such as the 30 percent tax credit. Accordingly:

We recommend the enactment of a proposal for a tax credit equal to 30 percent of the investment by United States investors in productive facilities in less developed areas, to be applied against the total United States tax liability of such investors.

The Committee also believes that the tax-sparing proposals which have been made from time to time in the past are worth further study. These are proposals which would allow the United States taxpayer, in the calculation of his U.S. liability, to receive a credit for taxes normally payable to a foreign government, but from which he has actually been "spared" by tax exemption or holidays under the laws of the foreign government. Accordingly:

We recommend that the encouragement to investment offered by such tax-sparing measures in less developed countries should not be negated by United State tax laws.

The Application of Antitrust Law

United States antitrust laws are another uncertainty besetting overseas investors. By their terms, some of these statutes apply not only to the activities of businessmen inside the United States but also to activities outside the country.

Statutes of this sort pose a dilemma. On the one hand, it is easy to envisage an agreement, entered into outside the United States, which stifles competition in the import or export of goods or services and which does injury to the United States economy. On the other hand, it is also easy to picture a case in which the managers of United States owned subsidiaries in foreign countries may find themselves obliged by United States law to adhere to standards of conduct different from those of their local competitors, thereby weakening their position in these countries.

This is a real problem. Nevertheless, the proposal sometimes made that "antitrust should stop at the water's edge" is hardly defensible in the light of United States interests involved in imports or exports. Besides, such a policy on the part of the United States could be construed by the rest of the world as a tacit confession that a free enterprise system is not an exportable commodity. On the other hand, the application of United States statutes to transactions abroad, without regard to the difference between domestic and foreign settings, would be equally indefensible.

From time to time, it has been suggested that United States antitrust agencies might make greater use of a procedure for the advance clearance of doubtful arrangements. The Committee believes it is unrealistic to hope that the businessman's uncertainty about the legality of his international arrangements under the antitrust laws can be reduced very much by an extension of the advance clearance procedure. In the case of international antitrust problems, what the authorities would be asked to judge in advance is a complex system of relationships which are likely to evolve and alter continuously over the years. In circumstances of that sort, the authorities can be expected to offer a "clearance" with so many qualifications that the procedure would be of little practical help to business.

Nevertheless, there may be other ways to take the edge off some of the genuine uncertainty now existing in the international antitrust field. One approach which the Committee believes has merit represents an extension of the practices which the United States Government has already begun to follow in cases with international ramifications—practices of consultation and collaboration with other foreign governments where the interests of nationals of those governments are involved in an antitrust suit.

Intergovernmental collaboration on antitrust cases can achieve one important objective for the businessman: while it cannot serve to clarify the murky corners of United States antitrust law, it may be able to reduce his problem of being responsive to the disparate standards of a number of different jurisdictions all at the same time. Such a possibility would exist if, for example, the United States were prepared in practice to agree with other selected countries on the limits of application of their respective jurisdiction in antitrust matters.

Fifteen years ago, such an approach might have come very close to the proposal that United States antitrust philosophy should stop at the water's edge; for, at that time, one would have had difficulty in finding a nation abroad with much interest in the maintenance of a vigorous competitive system. Today, however, the situation is changing. The European Economic Community is on the threshold of an extensive period of enforcement of its antitrust regulations. The Scandinavian nations now have a fairly significant record of effective antitrust enforcement, using their own distinctive standards and procedures. The United Kingdom, after nearly two decades of experimentation with different approaches to the antitrust problem, now is contemplating some added steps in the application of the philosophy. Canada also has an antitrust statute with a record of enforcement. In other countries, as well, the antitrust concept is active.

Our concern here, of course, is with investments in the less developed countries. The complexity of corporate ownership patterns is such, however, that the jurisdictions of the advanced nations may well be involved in arrangements affecting the less developed areas. Besides, methods of consultation and jurisdictional division worked out with the advanced nations may serve as prototypes of what may eventually be possible in agreements with less developed countries. Accordingly:

> *We recommend that the United States Government, working through its bilateral treaties of establishment, through the mechanisms provided by the* OECD, *or through other appropriate means, widen and strengthen its collaborative practices with other governments in the antitrust field. Wherever the activities of such governments seem likely to raise the problem of multiple standards and jurisdictional conflict in the application of antitrust policies, a major objective of the collaboration would be to reduce the uncertainty of the businessman concerning the jurisdictional authority and antitrust standards which would apply in his overseas activities.*

Section 3: The Flow of Finance Capital

Capital is a scarce resource in the less developed countries and its scarcity impedes development both in the public sector and in the private sector. To deal with it, a number of capital sources have been created by agreement between governments. Some have been bilateral in character, such as the loans and grants to governments under the United States aid program; some have been multilateral, such as the loans of the World Bank and the Inter-American Development Bank.

While public funds have been moving into the public sectors of the less developed countries, programs to direct capital toward the private sector have been slower in developing. This delay has been due in some countries to an ideological bias in favor of public investment. But more often, it has been due simply to the difficulties of mobilizing private capital and of channeling capital to the private sector. They are formidable in countries which are just beginning to modernize and grow.

Of course, not all types of capital are equally scarce in the private sectors of the less developed nations. Suppliers of equipment from many advanced countries, often acting with the help of their governments, are prepared to offer medium term credits to private enterprises in the less developed countries. The money market in New York readily absorbs the short-term dollar paper of a considerable number of well-known enterprises located in Latin America. But *long*-term capital or equity money is quite scarce, even for the well established venture. And, if the venture is small or untried, any kind of capital is scarce except at the most elevated rates of interest. This problem must be dealt with if a private sector is to flourish. And there is every reason to hope that the problem may be aided by appropriate action in which the private and public resources in the United States can play a part.

The Balance of Payments Issue

The first question which the United States has to face in dealing with this issue is whether it is prepared to allow its own foreign exchange resources to contribute to the solution.

For the past five or six years, the United States has been deeply concerned over the country's steady loss of gold. Understandably, our government has taken a number of steps to check the flow. In making public loans and grants in the foreign aid program, for instance, the United States Government has "tied" the aid so that the money would be spent on United States goods and services. About 85 percent of United States bilateral aid is now tied in this way.

In the private investment field formal "tying" of this kind is not feasible or desirable. Accordingly, over the past year or two, the Administration has felt the need to apply a series of measures to constrain the export of United States private capital. The principal measures have been: a 15 percent tax on certain types of capital raised by foreigners in the United States markets; a voluntary program by which United States parent companies would try to improve the net balance of payments effect of their overseas subsidiaries' operations by 15 or 20 percent; and a voluntary program by which United States banks would hold down increases in their foreign lending to 5 percent per annum.

From the start, official policy has sought to make clear that these restrictive measures were not directed at the less developed countries. For those countries, the United States aim of stimulating economic growth was to take precedence over its aim of controlling the outflow of United States capital. Accordingly, the 15 percent interest equalization tax was made applicable only to capital exports destined for the advanced countries. For the same reason, the voluntary program for improving the balance of payments performance of United States companies with foreign interests was limited to transactions with the advance countries.

But the distinction was badly blurred in the Federal Reserve Board's voluntary program for curbing overseas bank lending. Here, the ceiling imposed on bank loan increases was global in nature. The only special recognition given to the less developed countries was a recommendation to banks that, within the global quota, priorities be given first to export loans and, second, to loans for the less developed countries.

The available figures suggest that this formula markedly curbed loans which otherwise would have gone to the less developed areas. The recent monthly rate of long-term lending to the less developed areas by U.S. banks has been only about three-quarters as high as the rate in 1964. Although total loans outstanding to these areas from United States banks have been increasing by several hundred million dollars yearly in past years, indications are that such loans will be lower at the end of 1965 than at the end of 1964.

A curtailment of this sort defeats the United States objective of encouraging the development of the less developed countries and, above all, of the private sectors in those countries. What is more, there is a real question whether the curtailment does much to help the balance of payments position of the United States. It is characteristic of the less developed countries that, unlike the advanced nations, they spend every dollar of foreign exchange that they acquire as fast as they acquire it. Therefore, when the less developed countries acquire dollars through bank loans, the United States runs less risk that these dollars will be converted directly into a demand for scarce United States gold.* Only when these dollars fall into the hands of other advanced countries does the risk become real. Some of that kind of risk, it appears to the Committee, is worth taking in light of the critical importance of aiding the less developed areas. Accordingly:

> *We recommend that the Federal Reserve Board amend its recommendations to United States banks so that the restrictive effects on loans to less developed countries are eliminated.*

Legal and Institutional Reform

Seventy-odd countries in the world are generally regarded as "less developed." Each has its own law and institutional characteristics, and each presents its own special problems in the mobilization of long-term capital for productive enterprise. A few common problems, however, tend to be present in many of these countries.

One basic source of difficulty lies in long-standing provisions of the commercial and corporate law in many less developed countries, designed for another era and another kind of economy. There are numerous illustrations of this kind of difficulty.

In some countries, for instance, it is difficult or impossible to collect on defaulted debts unless some tangible security has been provided as collateral. This factor strengthens the tendency of banks and other lenders to provide loans only against collateral and to avoid extension of general lines of credit so common in advanced countries.

In other cases, the problem is of quite another kind. Under the corporate law of some countries, enterprises are prohibited from making additional stock offerings except through rights to stockholders. If a significant group of stockholders is

* Private investment flows from the U.S. to less developed countries in 1964 were $1.8 billion, and of this only $522 million were direct investments. The total amount included some $481 million of long-term bank lending and sales of securities in the U.S., and $803 million of short-term bank loans and commercial financing—Department of Commerce.

unwilling to increase its cash investment in the company and if no market can be developed for the rights, the company, in practice, may be prevented from increasing its equity. At the same time, other useful corporate instruments, such as the convertible debenture or the convertible preferred stock are ruled out.

Still another kind of problem arises when the law simply does not provide for or does not permit certain kinds of institutions. Major legal blocks can sometimes be found to bar such useful institutions as the open-end investment trust, the cooperative bank or credit union, the organized stock exchange, the factoring house, the leasing of capital assets, or the conditional sale.

Often the problems of developing an adequate local capital market are not so much problems of law as those of habit and custom. For example, in some countries the idea of having public stockholders is abhorrent both to the owners of the enterprises and to prospective investors. The owners cannot reconcile themselves to a situation in which outsiders share the prerogatives of ownership; and the outside investors cannot picture a situation in which the controlling stockholders would feel any responsibility for minority interests. Partly as a result, information of the kind that any serious investor requires is rarely available, even for very large enterprises, in the less developed world.

There does not appear to be any overwhelming reason why the leasing of fixed assets, the use of convertible securities, or the development of credit unions could not be introduced more widely. Unhappily, however, it is not enough to know what worked in the United States and Western Europe, in order to know what should be prescribed for the less developed countries. While some of the institutions and legal provisions of the advanced nations may be exceedingly desirable and constructive, others may be meaningless or impractical. The habits, institutions, capabilities and legal structures of less developed countries are, in many cases, too far removed from those of the advanced countries to permit any easy bridging of the gap.

Fortunately, a few nations seem to be making the transition from situations of the sort just described to more modern and more efficient institutions. In such nations, the government has commonly helped to create and support institutions which worked in harness with the private sector in various pragmatic ways. Japan, which is well along toward acquiring the full panoply of modern credit institutions, is achieving its modern status by a curious mixture of state banking institutions, government-private banking partnerships, unorthodox industrial lending policies, and even more unorthodox stock flotation practices. Mexico also has begun to achieve some breadth of securities ownership, using methods which would be regarded as unorthodox elsewhere. Mexico has resorted to such practices as government-financed market stabilization of privately issued securities and government-sponsored investment trusts whose portfolios consist principally of privately issued securities. The laws, institutions and experiences of countries such as these may prove more relevant than those of the more advanced countries. Accordingly:

We recommend that a large-scale program of assistance be expanded for the development and improvement of local financial institutions in support of private and cooperative enterprises in the less developed countries; and that the program draw heavily not only on the expertise of the United States and other advanced countries, but also on expertise in countries whose institutions may be more relevant to those of the less developed countries. Presumably, such a program could be conducted not only through the auspices of public international agencies such as the Organization of American States and the United Nations specialized agencies, but also through private organizations such as those in the cooperative and labor fields which have the necessary experience and interest.

The Encouragement of Financial Intermediaries

A number of steps for the mobilization of equity capital or long-term debt might generate results in a significant number of the less developed countries. One of these is the building up of intermediary institutions capable of mobilizing investor capital and of managing a portfolio of equity interests or long-term debt, such as development banks, savings institutions, or stock exchanges. In order for such institutions to succeed, they must command the confidence of both sides in the transaction. That is to say, such institutions must have the confidence of the principal owners and managers of the firms in which they take a significant interest, as well as the confidence of the investors who are providing the funds.

There are many encouraging examples of institutions which seem to have assumed this role with some degree of effectiveness in the less developed countries. In many countries, including Nigeria, Pakistan, Mexico and Turkey, official institutions such as the development banks have had outstanding successes. Elsewhere, locally-incorporated private or cooperative institutions seeded with foreign funds and analogous in form to United States investment trusts have produced excellent results. In addition, there have been promising foreign investing mechanisms purchasing for portfolio, such as ADELA. One successful institution, the International Finance Corporation, is a public international agency, wholly owned by the stockholders of the World Bank.

Still other institutions of this sort have been discussed. A proposed Peace-by-Investment Corporation, for instance, would channel equity funds into the less developed countries, using United States Government credits as its source of financing in the initial stages, and relying partly upon funds from private investors in later stages; this is one added approach which deserves the most careful consideration as a way of helping to fill the capital gap with private resources.

Institutions of this sort have far more potential importance in the less developed countries than in the advanced nations because they are sometimes capable of satisfying a number of special needs. First, such institutions may be in a position to undertake the initial investigations and the subsequent surveillance of investment opportunities; in countries in which corporate information is closely held, this is a critical function. Second, such institutions may be able to provide some degree of liquidity to their investors; in economies in which organized securities markets are lacking or are underdeveloped, this too can be of critical importance.

One of the more immediate methods to provide long-term money for the less developed areas relates to the International Finance Corporation. A proposal now before the United States Government is to allow the IFC to borrow $400 million from the World Bank. At the same time, the proposal would suspend the existing requirement that IFC transactions with a private enterprise in any country must be guaranteed by the government of that country. The Committee strongly endorses both points. Accordingly:

> *We urge the United States Government to approve a proposal to permit the* IFC *to borrow up to $400 million from the World Bank for investment in private enterprise in the less developed areas; and we urge approval of the provision eliminating the need for the guaranty of such transactions by governments in the country of investment.*

In its analysis of the problems of supporting non-governmental entities in the less developed countries, the Committee has come to believe that there is a real need to brush away some of the obstacles which are now impeding access to local currencies owned by the United States Government in those countries. The Committee is aware that the greater use of these currencies raises problems, such as the need to restrain money supplies when inflation threatens, and the need to avoid policies which discriminate against local businessmen in favor of their foreign competitors. Nevertheless, use of these currencies could be widened and one productive channel is the provision of seed money for financial intermediaries.

There have already been a few instances of this in connection with the establishment of industrial banks and home financing institutions. The Committee believes this could readily be extended to entities which perform other roles, such as cooperative banks, investment companies, and mutual funds. Accordingly:

> *We recommend that* AID *review its policies with a view to widening the use of United States-owned local curren-*

cies; and in that connection, that it give serious consideration to the greater use of those currencies for increasing the capital base of financial intermediaries of both the commercial and cooperative types.

While the United States can increase the capital resources of financial intermediaries through local currency loans, it can also increase their resources by tax incentives to investors which provide the funds. For some individual and institutional investors building up a diversified portfolio of investments, the impact of a tax advantage can be considerable. Such investors ("portfolio investors," so-called) are ordinarily in a position to weigh many more alternatives and to figure the yield and risk considerations much more closely than the direct investor concerned with the operation of an overseas subsidiary. Accordingly, any tax advantage extended to a portfolio investor will figure explicitly in the appraisal of alternatives. Hence:

We urge the Administration to consider the possibility that any United States tax credits extended by treaty or legislation to the direct investments of United States investors in less developed countries, such as the 7% and 30% credits proposed in Section 2, also should be extended to the portfolio investments of United States corporate or institutional investors, wherever such investments meet the eligibility criteria which would apply to direct investments.

The Use of Guaranties

For many institutional investors, however, neither tax incentives nor loans will have much effect in stepping up the flow of long-term capital from the United States to the less developed countries. Pension trusts, insurance companies and other institutional investors, for instance, are unlikely to examine any lending opportunity seriously, however lucrative its yield, if the opportunity involves any significant risk. Funds of this sort must be managed on a fiduciary or quasi-fiduciary basis. Hence, the standard of "the prudent man," conservatively interpreted, must generally be applied. The risk of criticism is always greater, therefore, when an institutional investor pursues a relatively untried course, such as investment in the less developed areas. Yet the funds of institutional investors may provide an indispensable element in financing productive investment in the less developed areas.

No great single step will sharply increase the receptivity of institutional investors toward commitments in the less developed areas. But a series of lesser measures, taken collectively, might change the prevailing state of mind. Some of these go back to the general "climate," discussed in Section 2. Others are more specific. For instance, where countries have laws or constitutional provisions which specifically guarantee a foreign investor against arbitrary governmental treatment, the United States would do well to consider whether such guaranties cover portfolio investment. If they do not, as is sometimes the case, any efforts to improve the investment climate of such countries ought to include the objective of extending the existing guaranties.

In addition, however, the United States itself should take steps to ease the grant of specific and extended risk guaranties for the portfolio investor. AID has already shown a willingness to experiment in adapting its guaranties to portfolio investments. We think this trend should be accelerated. Specifically:

> *We recommend that* AID *tailor its specific risk guaranties to permit their easier availability to United States buyers of selected issues of foreign private enterprises. Among the possibilities which* AID *should explore is: arranging for the application of such guaranties through negotiation and agreement with the underwriters rather than with the ultimate buyers, thereby sparing the buyers the cost and difficulty of direct negotiations and ensuring a wider United States market for the securities involved.*

It is the extended risk guaranty, however, which the Committee thinks may be a real hope for increasing the flow of portfolio funds to the less developed areas. In Section 2, we recommended that a 100 percent extended risk guaranty be available for a part of the capital provided for certain projects in the less developed countries. This provision would, of course, be available for portfolio investors if they were the source of such capital. In addition, however, we believe that AID should be encouraged to experiment with less-than-100 percent coverages for portfolio investors, where these seem useful. Accordingly:

> *We recommend that* AID *offer portfolio investors extended risk guaranties, combining risk-yield features which make selected securities of private enterprises in the less developed countries competitive with the alternative opportunities of such investors.*

The Sectors to be Supported

Every country which supports a program of foreign aid or which insures or subsidizes the foreign investment of its citizens is caught up from time to time in a tangle of conflicting considerations. On the one hand, the aid-giving country sees advantages in contributing to the growth and support of the less developed country; yet, on the other hand, occasionally fears the consequences of the increased competitive strength of the area receiving the aid.

This conflict is painfully sharp when an aid program in a less developed country is designed to build up additional production in an industry or branch of agriculture which is already in economic difficulty in the aid-giving country. If the project in the less developed country is a textile plant, for instance, the United States might understandably be worried about creating added spinning capacity at a time when United States textile mills were not fully employed; if the project was to increase cattle production, the United States might be concerned by the fact that meat appeared to be in surplus at home; and if the project was aimed at expanding rice production, the United States might well wonder about the United States rice surplus already being financed out of United States tax money.

Nevertheless, there is not the slightest doubt where United States interests lie. Our political and our economic interests are best served by building up the productive capabilities and democratic institutions of the less developed countries. It is important, of course, that these development programs should be sensibly conceived; but sensible programs sometimes include the expansion of output of products which are in surplus in the United States. The evidence is overwhelming that the best customers of the United States are also the countries which seem to be our strongest competitors. The competition, in the end, is sorted out through adjustments and shifts on the part of both parties. Overall demand for United States products, altered though it may be, survives the shifts.

As a general rule, United States officials in AID and United States representatives to international agencies try diligently not to be diverted from their principal development purposes while dealing with pressures of individual United States industries or agricultural groups. But considerations such as these inevitably tend to build up in the analysis of any given project. And unless there is a clear, strong line inside the complex United States Government establishment, the tendency on the part of government officials, when considerations of this sort exist, may be to hesitate, procrastinate and qualify.

There is irony in the fact that when the prospective recipient of United States or international aid is a private enterprise, the intrusion of extraneous considerations of the sort just described is even greater than when a public enterprise is involved. This is so partly because government enterprises tend to be concentrated in infrastructure and heavy industry while private enterprise tends to specialize in lighter manufacturing activities. Accordingly, loans to private enterprise are more likely to provoke questions of international competition. Besides, the governments of the less developed countries tend to defend their own governmental projects more effectively than the projects of their private businessmen. The result is lopsided in terms of United States long-run interests; government enterprise projects often have clearer sailing than those of the private sector.

In a society as complex and as pluralistic in nature as the United States, it is inevitable that pressures such as these will continually arise. But it is one of the obvious principles of effective administration that any program should confine itself to a limited number of major objectives; otherwise, the program may serve no objective at all. In this case, we must never lose sight of the fact that our prime objective is the economic growth of the aid-receiving countries. At times, that objective will lead United States officials to take a considerable interest in the avoidance of harmful policies in aid-receiving countries, such as policies relating to the existence of destructive monopolies, or harmful land tenure arrangements. United States aid officials also should be interested in situations in which the competitive advantage of a foreign country is based upon exploitative wages—wages which are excessively low in light of the productivity levels in the country concerned; for wages of this sort are hurtful not only to competitive United States industry but also to the growth of the developing country itself. Interests of this sort, specific though they may be, are still essential to support the general objectives of foreign aid. Accordingly:

> *We recommend that, in the administration of its aid programs in the less developed countries, United States representatives be instructed to subordinate other objectives to that of securing the economic and social development of the less developed nations. In this connection, it should be recognized that United States interests are usually best served by testing any project in these terms, rather than in terms of whether the project would affect the competitive position of particular branches of United States industry or United States agriculture.*

Section 4: Developing Human Resources

Economic development depends above all upon the upgrading of human resources and the improvement of institutions through which development is achieved. Capital, though necessary, cannot achieve by itself these improvements. A critical question is how best to provide the necessary human and institutional changes.

The Educational Structure

Part of the answer–a very large part in most cases—lies in the improvement of education in the less developed nations. When we speak of education in this context, we mean education in its broadest sense. There is not only a need to spread literacy; there is also the need to spread explicit skills relevant to the tasks that confront every nation.

In almost all cases, agricultural skills rank very high in the priority needs of the less developed countries. Some of these are simple skills, such as cultivation and conservation practices. Some are far more complex skills requiring the establishment of agricultural colleges or institutes of engineering.

Nor dare we neglect the training of a skilled and semiskilled work force, intended for industry, construction, transport and the like. Such training has been much ignored in the past, too often on the easy assumption that labor of this sort is spontaneously available. Nothing could be further from the facts. When a vacuum exists in the middle ranks of the industrial labor force, the industrial economy is bound to be crippled.

Men skilled in the technical and managerial fields are in chronic short supply in the less developed countries. Filling these deficits is especially difficult because of the long lead time needed for training.

In developing an adequate educational strategy, the problem is not only one of assessing needs but also one of maintaining balance. There are well-defined pressing short-term needs, and less precisely defined long-term needs. The limited available resources cannot satisfy all needs. The challenge to sensible planning is to maintain a proper appreciation of both kinds of need.

AID programs in most countries place a certain amount of stress on education and educational planning. But our impression is that much more attention and resources are needed for planning and execution of educational programs. We see this as a key issue affecting every facet of the development process. Accordingly:

> *We strongly urge* AID, *in reviewing and responding to a country's development strategy, to place major emphasis upon the planning, host country commitments to, and the execution of educational programs. In such programs, we urge* AID *to use every means to tap the rich resources in United States universities, labor unions, cooperatives, business enterprises, professional societies, and other non-governmental entities which have something to offer to the educational process.*

In the pages that follow, the Committee will have more to say on specific steps that might be taken to further this objective.

Export of Industrial Skills

There are many channels through which to assist the less developed countries in their formidable job of education. Where management skills and technical skills are concerned, the foreign branches, subsidiaries and affiliates of United States firms can make a major educational contribution. Numerous other sources in the United States are prepared to provide managerial and technical help to industry on a commercial basis. These include many engineering and management firms with a wide range of specializations and considerable experience. Still, the Committee believes that the network of communication between the prospective sources of industrial assistance in the advanced countries and the prospective recipients in the less developed countries suffers from major gaps.

We begin with the fact that, except in the case of direct investment, ordinarily a great gulf exists between the prospective source of managerial or technical assistance in an advanced country and the prospective recipient of such assistance in the less developed world. In the typical case, the enterprise in the less developed countries that might benefit from the assistance does not even exist; it is no more than an amorphous idea in the mind of some individual or local industrial bank. Or if the enterprise does exist, its conception of how it might be helped and who might help it is vague and formless. Some source of initiative is needed to focus the problem, define the possibilities, and search out the necessary managerial or technical assistance; and it would be unrealistic to assume that such initiative will be generated spontaneously from either local or foreign sources. This is why the Committee recommended in Section 2 that there should be a greatly stepped-up effort to increase the flow of feasibility studies in the less developed areas, and a major strengthening of institutions with a stake in bringing some of those studies to fruition.

If the flow of feasibility studies is greatly increased, one can hope that foreign enterprises will be persuaded to make more investments in the less developed areas. But that possibility exists only for a limited range of opportunities. To be sure, in cases in which the scale of a proposed enterprise is relatively large and the technology is relatively advanced, there may be United States companies interested in the possibility of setting up a subsidiary or affiliate. If the scale is small and the process is simple, however, few United States companies are likely to have an interest in the operation. Measured against alternative possibilities in the United States, prospective profits in the less developed countries may seem small and risks may appear uncomfortably high. Accordingly, in the less developed countries, operations such as bakeries and dairies, paper box plants and rubber footwear plants, trucking depots and supermarkets, may be unable to secure the American managerial and technical skills needed.

If the United States firms are unwilling to invest in such enterprises, would they be willing to sell their managerial and technical skills on a fee basis to moderate-sized firms in the less developed world? On first blush, the picture is not encouraging. United States enterprises offering technical assistance to enterprises abroad use various formulas for compensation. If the agreement is broad in scope, the aided firm generally pays some percentage of the value of its sales for the services; percentage figures in the range of 4 to 8 percent are typical. The agreement may also provide for reimbursement of the out-of-pocket costs of the assisting firm.

As a rule, in arrangements of this sort, both the receivers and the givers of technical assistance are relatively large firms. Small firms that need technical assistance often have difficulty in paying for it; and small firms possessing the technology in the advanced countries often have difficulty in finding a way to export it. When a small firm is asked to provide assistance, the cost of detaching a key officer from his regular duties at home may seem especially high. The problem is to find a way of providing an adequate level of compensation which reflects the full cost incurred by the assisting firm in diverting its manpower from home-based activities.

The block to adequate payment does not arise simply from the inability of the receiving firm to pay for and the assisting firm to provide the required services. Even if both firms were willing, the governments in less developed areas are often unwilling to permit arrangements in which the compensation rate seems high, according to "local" standards. This reluctance is due partly to an unwillingness to permit the spending of scarce foreign exchange for services that may seem overpriced; but it also is due in part to the fact that foreign parent companies have sometimes been suspected of charging their subsidiaries very high fees in order to draw out profits in the form of expenses. As a result, yardsticks for licensing fees have been developed in some countries which at times impede the easy flow of technical assistance.

Even though the private recipients may be in no position to pay for technical assistance out of their own resources and even though governments may resist "abnormal" payment formulas, we believe that there are times when such assistance is well worth providing.

When technical assistance has an initial seeding effect which introduces new skills and sets new standards of performance, it can generate benefits to the receiving country exceeding anything that is reflected in the amount that the recipient firm could be expected to pay. The Committee believes, therefore, that wherever technology or managerial assistance may have a major seeding effect in an aid-receiving country, AID would be well justified in subsidizing the sale of such technology or assistance to the degree appropriate to reflect its full effects in the less developed country. Accordingly:

> *We recommend that, in selected cases,* AID *partially finance the sale of technical, professional or managerial assistance from United States organizations to entities in less developed countries, and that the subsidy contribute not only to the costs of the assisting enterprise but also to the costs of searching out and finding the appropriate source of such assistance.*

The principle of AID subsidy for seeding managerial and industrial skills is not new. AID has supported numerous projects to train and educate local managers and the local labor force, through supporting such institutions as the Asian Productivity Organization, business schools and vocational education programs, the labor education center in the Philippines, and industrial technical assistance projects. AID has also vigorously supported the recruitment and training of management personnel to run cooperative housing, production and marketing ventures in the less developed countries.

The Committee has the impression, however, that there are still a significant number of rich, unexploited opportunities by which AID, acting in conjunction with foreign private groups already operating in some countries, might increase the total effectiveness of United States efforts. The Committee has been briefed on some of the unusual industrial training efforts sponsored by United States labor organizations in less developed areas. A tailoring school in Kenya, a motor vehicle maintenance school in Nigeria, and a steel workers' school in India illustrate the many industrial projects in which American labor organizations have participated. The Committee is also aware that American-owned subsidiaries and affiliates in the less developed countries already do a considerable amount of such training. Some do it simply as a normal part of their plant routine; a few pursue such training much more formally as a contribution to the development of the host country.

The use of existing industrial facilities of foreign subsidiaries for training local managers and the local labor force is desirable on many grounds. It can often be launched without much added capital investment. It can dramatize more effectively the modernizing influence of such foreign investment. And it can be used as part of an integrated program with other development efforts, such as the efforts of local industrial banks to make up a package to attract new industrial investors or the efforts of local productivity centers to enrich their industrial training programs. Where such a program involves significant amounts of added cost to the enterprise concerned, however, there is a case for AID assistance in financing such activities.

In sum, we see the possibility for a greatly expanded role for the United States aid program in building up the vocational, managerial and professional foundation of a society based on private enterprise, cooperative ventures, and other non-governmental enterprise activities. We see some of this role being achieved in cooperation with various private groups, including universities, labor unions, cooperatives, and enterprises operating abroad. Accordingly:

> *We urge* AID *to actively promote the development of management schools and vocational institutions in the less developed countries capable of generating the manpower needed for the management and operation of a society based on principles of private enterprises, cooperative ventures, and other non-centralized enterprise forms. We also recommend that* AID *survey the possibilities of more extensive use of facilities of American-owned subsidiaries and affiliates in the less developed countries for training purposes; and that it undertake to provide financial support, using local currency as available, for such added training activities as these enterprises or other organizations might be willing to undertake with the use of those facilities.*

Export of Professional Skills

There are a profusion of person-to-person contacts between managers and technicians in the advanced countries and those in the less developed areas, arranged through governments, through private enterprises, through foundations, through labor unions, and through many other types of organizations.

Among the many productive contacts that have developed are those between members of the construction industry of the United States and their counterparts in the less developed nations. These contacts, for the most part, have been the result of joint work in the field. AID's major role in promoting such contacts is suggested by the fact that American engineering and construction firms have been working on AID-assisted projects amounting to about one billion dollars annually.

The creation of public works and private structures has always been an important training ground for managers, engineers, architects and craftsmen in the less developed areas. Its importance as a training ground has been enhanced by the fact that the United States and international agencies, when financing construction in the less developed areas, have ordinarily insisted upon appropriate standards of design and workmanship. This, in turn, has brought a steady flow of foreign consulting engineers, architects and construction specialists into the underdeveloped areas. In many cases, these specialists have broadened their impact by conducting formal training courses for local construction personnel. These training courses have been so useful, in fact, that we believe that AID should make provision for such courses as a normal part of any major contract for construction or design.

United States technical assistance from the private sector is not, of course, confined to engineering and construction skills. A considerable number of other professions have offered their services on a contract basis in the less developed countries. A number of management consulting and economic research firms, for instance, have acquired valuable experience in less developed countries.

For a time, it appeared that the United States private sector might be inadequately represented in the flow of technical assistance of this sort. Earlier versions of the Foreign Assistance Act had directed the President, as a matter of preference, to draw on governmental resources in the technical assistance field whenever such resources were available. The Committee is pleased to note that the Foreign Assistance Act of 1963 reversed the order of preference, so that technical assistance is first sought from private enterprise on a contract basis. In practice, this has come to mean that when the skills of government agencies are called upon, they usually are of a kind which cannot readily be found in the private sector. For example, the Committee notes with approval that government agencies skilled in public works, such as the United States Bureau of Reclamation and the Bureau of Public Roads, usually limit their interests to large general problems of national public works planning, while private firms are used to handle the more specific design, supervision, and construction problems.

The many contacts between United States private firms and local counterpart professional groups have produced some exceedingly fruitful results. In Turkey and Iran, for instance, the recent appearance of a skilled and competent body of local private engineers can be credited partly to such contacts.

Effective private participation in these technical assistance activities could be widened, however, if the various financing and guaranty facilities which now are extended to exporters of goods from the United States private sector were as readily extended to "exporters" of personal services. In some cases, the firms involved cannot afford to finance their activities over an extended period of time, while awaiting payment from the private organization or government agency to which their services are being extended. In other cases, such firms are understandably unwilling to accept the special risks of inconvertibility or political change that may be involved while awaiting payment. This is a difficult and complex field, to which AID and the Export-Import Bank have been giving increasing attention; indeed, a number of steps have been taken of late which seem formally to expand the facilities available to firms rendering technical assistance abroad. But our strong impression is that more progress can be made to place "exporters" of services on a parity with exporters of goods. Accordingly:

> *We recommend that* AID *and the Export-Import Bank review their present policies for extending guaranties and export credits to exports of technical and professional services destined for the less developed areas, with the object of eliminating any remaining disparities of treatment between exports of services and exports of goods.*

Export of Agricultural Skills

About two-thirds of the work force in the less developed countries earn their livelihood from the land. Practically all the people of such countries depend upon local food supplies for their existence. The desperate race between population growth and food production in the less developed countries is so well known and so widely documented that we need not labor it here. So critical is this problem that it justifies the greatest attention of AID. Where industrial feasibility studies are concerned, those which relate to expanding the supply of fertilizer or insecticides or which relate to the transport and processing of foods will merit an especially high priority. Where technical assistance programs are being considered, those which can draw more agricultural expertise out of United States colleges and extension services should merit the highest attention. Where persons skilled in cooperative practices can be tapped, their assignment to the development of cooperative organizations in the agriculture field should be given first consideration.

It is precisely because the promotion of agriculture rates so high in the list of development objectives and because that promotion involves so much of the economy of the less developed countries that the Committee finds it difficult to isolate any particular facet of the issue for special consideration. We can only urge that all the detailed recommendations contained in other parts of this report be read in the light of our special concern for the future of agricultural production in the less developed world.

Generation and Adaptation of New Knowledge

It must not be assumed, however, that enough knowledge already exists in the United States to permit us to prescribe what needs to be taught in the less developed areas. One lesson which has been driven home to those who are familiar with technical assistance programs is the basic fact that techniques which work in Topeka, Kansas, may have little relevance in Tegucigalpa, Honduras. All the knowledge that is needed for efficient economic development simply does not yet exist.

It is in the field of agriculture, in fact, that our ignorance is most in evidence. The necessary programs in this sector cover such disparate subjects as: changing the structure of village cultures; altering the institutions of land tenure; developing an appropriate educational system; building a system of farm-to-market roads or irrigation works or drainage canals; creating the rural institutional base through which help can be channeled; generating an effective credit and marketing system; and developing an industrial complex capable of providing the machinery, chemicals and other processed materials that are needed by modern agriculture.

A greatly expanded program of agricultural research is needed. Among the lines of research activity that seem self-evident to the Committee are these: much more research on the physical impediments to agricultural productivity, country by country, region by region, crop by crop; much more research on the development of appropriate plant strains and production techniques, by areas and by crops; much greater understanding of the cultural and institutional barriers to increased output; greatly increased testing of rival approaches to agricultural organizations and education. These lines of agricultural research, however, should be thought of as illustrative, rather than exhaustive. A review of some of the on-going programs in some countries, such as the Comilla experiment in East Pakistan, the International Rice Research Institute in the Philippines, and the Rockefeller Foundation's cooperative work in corn, wheat and potatoes at the National Institute of Agricultural Research in Mexico, will suggest added approaches capable of extension to other areas and other crops.

Our ignorance of what works and what does not is also evident in fields other than agriculture. For example, we are unsure about the kind of public administrative systems that might work in the varied circumstances of Latin America, Africa and Asia. We are uncertain about the type of educational techniques and educational curricula that might be most appropriate to the state of literacy and kind of society encountered in these areas. And, ironically enough, we are even unclear about the type of industrial technology which might be most appropriate to the little markets and underdeveloped industrial environments that are characteristic of the less developed world.

It is difficult to specify the research that is needed to cover all these areas. In the industrial sector, however, the problem is partly one of finding efficient production processes in a range of industries—"efficient" in the sense that they are capable of operating on a relatively small scale with a minimum of reliance upon expert maintenance. As a beginning, AID might well identify a number of industrial processes in which the problem commonly arises and might support research in these areas by qualified research institutes, wherever they may be. Accordingly:

> *We recommend that AID finance increased research imaginatively related to the agricultural, industrial, educational and administrative needs of the less developed countries. In some of these fields, such as agriculture, education, and administration, the research would no doubt have to draw heavily upon United States resources, of the sort that can be provided by universities, agricultural research institutions, and the like; but the experimentation itself would usually take place in the less developed areas themselves and should be directed towards strengthening research institutions and capabilities within these areas. Defining the problems to be studied and identifying qualified research capabilities requires of AID considerably more skill and more effort to involve the less developed countries than has heretofore been characteristic. Some of this activity might be financed by United States owned local currency where available.*

The Role of the Non-Profit Institutions

As some of our earlier discussion has indicated, much of the significant work undertaken by Americans in helping to upgrade people and institutions in the less developed world has been done neither by public officials nor by private business; it has sprung spontaneously from the non-profit organizations of all types which are so prominent a feature of American life. Some of the accomplishments of these groups have been striking: the strengthening of educational systems; the formation of democratic trade union movements; the establishment of credit unions and housing cooperatives; and the planning of national economic and social progress. The initiative of so many groups in extending a hand to counterpart organizations, often without support or recognition from official sources, is a tribute to the strength of American pluralism.

In some cases, however, activities of this sort have required outside help. To fill this need, AID in some instances has provided assistance either in hard dollars, local currency, or surplus food and freight costs. But there have been times when groups such as these have felt frustrated by their seeming inability to draw swiftly and easily upon official support for productive local activities in the less developed countries.

In Section 5, we shall propose some general organizational measures which will have a bearing on the aid program's future role in this area. Whether or not these general organizational measures are adopted, we see certain substantive steps as being widely desirable. It seems clear that non-profit organizations which spring up in the less developed countries, such as incipient cooperatives, young labor unions, and new hospitals or schools, as a general rule are even more ignorant of the possible sources of outside help than a prospective entrepreneur would be. The job of fashioning a bridge between such groups and potential sources of technical assistance abroad is extremely difficult. The job will take more money and attention, much more of both than so far has been available. Accordingly:

> *We recommend that* AID *assist in financing the development of appropriate non-profit institutions in the less developed countries and that it finance the development of links between such organizations and their counterparts in the United States through which technical assistance could be effectively provided. Assistance of this sort could take many forms, from such familiar activities as assisting educational institutions to supporting public forums and discussion groups. We see this activity, too, as a fruitful possibility for the expenditure of United States-owned local currencies.*

Section 5: Some Issues of Organization

AID is directly responsible for the commitment of about $2.1 billion annually for economic assistance. Through these funds, it administers a wide range of programs, from the sponsorship of research to the extension of guaranties. To perform these functions, AID has about 6,700 Americans on its payrolls, of whom 3,900 are abroad and 2,800 in the United States.

The Committee's task is not to appraise the operating efficiency of this complex, far-flung operation. Such an appraisal is a highly specialized and difficult job, which bears only peripherally upon the Committee's concerns. The Committee has no doubt that, in an organization whose mission is as difficult and heterogeneous as that of AID, any such survey would inevitably turn up opportunities for improvement. The Committee is also clear that some of the seeming shortcomings in AID administration are unavoidable consequences of the legal and administrative structure of the Federal Government itself. The endless effort to remain above criticism—public, Congressional or Executive—imposes burdens on AID operations which are unmatched in the private sector. The need to coordinate all activity with the State Department and other branches of government also adds a dimension which gives the appearance of slowing and blurring the action of the agency.

The Committee's administrative proposals, therefore, are directed only to its main objective—the objective of releasing the energies and resources outside of government in the economic and social development of the less developed countries. These proposals stem far less from a critical view of AID's performance than from a sober recognition of the limitations under which it is obliged by circumstance to operate.

Programs versus Projects

For many years, two different approaches to foreign aid have competed for resources within the foreign aid program. One is the concept that funds should finance specific projects—identified, engineered, blue-printed proposals for dams or roads or plants. The other is the idea that funds finance some of the resources needed to execute a general national plan.

AID has striven to have both—a sensible national plan for each major aid-receiving country and a well-developed set of specific projects. Frequently, however, AID has confronted the case of a country which seemed to have a perfectly justifiable case for receiving foreign aid but which did not have enough specific projects to which the aid might be attached; that is, a country which seemed to have a reasonable general plan, but a plan that did not include the kind of project activity which provided an easy focal point to which to affix the aid. In such cases, the needs to be financed have sometimes included heavy imports of spare parts or raw materials, in order to increase the rate of operation of *existing* plants; or large requirements for imports of light machinery, for use by a highly dispersed complex of light industry.

As between the two aid-giving patterns, Congressional committees have in the past usually expressed their strong preference for the project approach. The reasons for the preference are perfectly clear. When United States aid is identified with a specific project, there is a seeming basis for accountability, for determining whether the plan was well-drawn and the money was well-spent, which is far more obvious than in the case of the so-called program loan. The bricks and mortar are visible and tangible, a test of United States capabilities and a witness to United States willingness to provide aid.

Most sensible programs of economic development require a certain amount of large, visible installations and projects. But it is ironic that our desire for visibility and accountability frequently diverts our help from its most productive uses. Often the greatest need of a developing country is to infuse machinery, spare parts and materials into an economy that has been starved for these essentials. The sector which benefits most from such infusions, experience indicates, is the private sector. That sector's response to help of this sort has at time been spectacularly productive.

Fortunately, AID has resisted some of the pressures to concentrate upon large projects and frequently has financed large program loans in some of the aid-receiving countries, sometimes with striking results. Accordingly:

> *We urge the Congress to encourage not only well-conceived* PROJECT *loans but also well-conceived* PROGRAM *loans in the administration of United States aid, especi-*

ally when such program loans would stimulate the local private sector to a greater contribution in the process of social and economic development.

Tapping Non-Government Resources

Perhaps the most pervasive organizational difficulty which the Committee has encountered in its survey of United States aid administration is the underdeveloped state of liaison and coordination between official governmental agencies and non-governmental organizations, both in the United States and in the aid-receiving countries.

This is not a surprising state of affairs; indeed, it would be surprising if it were otherwise. Many of the tasks to which the business enterprise, the labor union, the university and the government agencies are gearing themselves in the field of economic development are new and unprecedented. The need for intimate and continuous communication between the public and the private sectors which the present situation requires, therefore, is almost without parallel.

It would be an overstatement to say that the machinery for effective communication and collaboration between AID and the private sector is wholly absent. Indeed, in the past few years AID has gone to great lengths to find ways to try to build that machinery. A staff concerned with the role of private enterprise in the aid program has been created in AID. In addition, AID officers have regularly engaged in conferences with labor unions, agricultural groups, universities, foundations, voluntary agencies, and others concerning various aspects of the AID program. But there are still major AID missions abroad which have no effective officers concerned with building up the non-governmental role in the aid program.

One measure which the Committee regards as indispensable is the strengthening and extending of the present private enterprise staff, both in Washington and in the field, so that it is effectively represented throughout the administration of the aid program. The difficulty in carrying out such recommendations in the past has principally been one of recruitment; with a few notable exceptions it has been extremely difficult for AID to secure men with the appropriate background from the non-governmental sector.

We believe that business organizations, labor unions, foundations, and other organizations would be prepared to assist in the recruitment of such personnel, in a framework in which the men involved were rotated back to their respective organizations after a period of time in the service of AID. Such tours of duty would be of value not to AID alone, but also to the organizations and individuals concerned. Further, we believe that this need is particularly urgent in relation to private enterprise development and that recruitment of seasoned business executives with broad international experience should be given particular emphasis. Accordingly:

We recommend that AID *expand and improve its organization both in Washington and in the principal missions abroad so that it is appropriately staffed with persons who, by experience and competence, are capable of acting as an effective conduit between the private sector and the official aid organization. In this connection, we urge* AID *to take steps to establish a basis for co-opting men from the private sector for rotation back to their permanent organizations after a tour with* AID.

The Delegation of Operating Responsibilities

AID's activities form a spectrum which extends from the most general kind of national planning operations to the most specific sort of day-to-day lending and guarantying operations. Having in mind some of the operating advantages of private organizations over governmental bureaus, the Committee gave a good deal of thought to the possibility of AID's delegating some of its operating responsibilities to private organizations.

Even under existing patterns of operation, of course, a certain amount of delegation takes place. Every time that AID decides to contract out some of its work instead of using its own staff, the delegation of operating responsibilities is involved. While the direct hire of personnel sometimes seems less costly, there are numerous situations in which contracting makes good operating sense. It is easy to create a misleading appearance of economy by the use of the direct hire route; the appearance is especially misleading when it leaves a residue of specialized personnel in the AID agency who must be kept at work on a succession of jobs for which they are not well-qualified. Besides, nongovernmental organizations in the United States have specialists in many fields whose experience and skill often exceeds those which AID or any other organization could muster for their own needs. In the unceasing effort to mobilize the best United States talent to the aid task, therefore, the use of the contractor route can be an exceedingly efficient arrangement.

The Committee would emphasize, however, that simply contracting with an appropriate institution does not assure effective assistance. The skills of the individual nominated by that institution to direct the project are more important than the character of the institution itself. Accordingly:

We commend AID *for its increasing use of contractors in the handling of specialized tasks and urge the Agency to extend this practice.*

In the efforts of the United States Government to reach out beyond the government sector and to involve the best available expertise in the program of economic development, the establishment of effective contact with non-profit organizations has been in some ways more difficult than communication with the business community. When businessmen have services to offer to the government, a clear incentive for breaking through the barriers of government regulations and procedures usually exists. Non-profit organizations, whose technical assistance commitments, in fact, exceed the technical assistance funds administered by AID, ordinarily do not have these incentives; their programs may indeed suffer from too close an identity with the assistance programs of such a political instrument as AID. Accordingly, it is often difficult or impossible to bring the resources of government and of the non-profit organizations into an effective working relationship.

This is not an altogether new problem for the United States Government. In other contexts, the Government has tried to handle the problem in different ways. One pattern, for example, has been the creation of essentially private corporations for essentially public work. Another pattern has been the creation of public corporations or public agencies with exemption from many of the normal administrative requirements imposed by government. The form to be used depends in part on the particular function of the hybrid public-private agency involved.

The Committee has given a good deal of thought to the problem of generating one or more non-profit, quasi-private institutions which would link national or regional development programs with the resources of foundations, universities, labor unions, cooperatives, professional groups, and charitable and religious organizations. Such institutions, as the Committee sees it, could receive funds directly from the Congress, on contract from AID, from private resources such as foundations and other organizations, and from foreign governments. These institutions should be subject to as few of the restraining governmental regulations and statutory requirements as possible, consistent with the need to account for the expenditure of their funds. They should be free, for instance, to make much more flexible arrangements for the employment of academic personnel than AID itself is now able to do. Ideally, they would tend to reduce the sense of frustration and delay which non-profit organizations often feel in their dealings with government; they would tend to shorten the line of communications in technical assistance programs, so that policies agreed at the top between AID and the non-profit organizations were not subject to frustration in the field; and they would tend to remove from publicly-funded technical assistance programs the political constraints inherent in AID which reduce the effectiveness overseas of AID's technical assistance program and which discourage the coordination of private and public assistance efforts.

More explicitly, such institutions would have three specific functions at the outset: (1) the administration of technical assistance programs both in countries, such as Libya and Saudi Arabia, which do not receive foreign aid in the usual sense and those, where AID programs are being terminated but which need help in improving their human resources; (2) the exchange of plans and information among United States foundations, universities, professional societies, charitable and religious organizations, regarding their activities in the less developed countries; and (3) the maintaining of contacts with non-profit organizations in these countries.

In due course, it should be possible to enlarge these responsibilities so that the new organizations might take over some of AID'S responsibilities for technical assistance programs in countries in which AID was providing program and other financial assistance; this step would presumably come later and then only in close conjunction with AID. What is needed now is an early beginning in the bridge-building process. Accordingly:

> *We recommend that the Administration formulate specific proposals aimed at creating one or more organizations which could increase the technical assistance commitments of private groups and in time more effectively administer publicly-funded technical assistance programs in coordination with those which are privately-funded. In view of the urgency of the problem, such proposals should be prepared in time for consideration and adoption in next year's* AID *program.*

While stressing the need for communication between the public and the private sectors in the United States aid program, we dare not lose sight of the fact that there are some activities by private groups in less developed areas which are all the more effective for being independent of the official United States establishment. Their independence from government support represents a strength for which the Soviet Union and the Communist Chinese have no counterpart in their foreign aid programs. Besides, their independence imparts an added measure of strength to the local institutions which they support; these institutions are less vulnerable to indications of displeasure from their own governments, and more disposed to take some of the independent positions which a pluralistic society demands. In some countries, considerations of this sort are vital in connection with certain programs such as the training of community leaders and the education of business and professional groups—programs which are now being assisted by United States educational groups business organizations, and private foundations. Activities of this sort, operating on the margin of the national sensitivities of the less developed countries, may find it desirable to avoid the drawbacks of official United States support.

There are some activities of this sort, however, which could be supported and stimulated by United States aid, provided that the aid was made available through the neutralizing filter of some local entity—some entity whose loyalty and commitment to the local culture and to the host government in the less developed country were beyond question. One approach to this need is suggested by the imaginative experiment which AID is exploring in India, where a binational non-profit foundation would be set up and financed to support a wide variety of educational and scientific programs. An entity of this sort could forge one more effective link in a chain which brought non-governmental groups in the United States in closer and more effective contact with their counterparts abroad. Accordingly:

> *We commend* AID *on its initiative in seeking the creation of a binational non-profit foundation in India; we urge* AID *to press forward with this experiment as a matter of high priority; and we urge that, if initial indications are encouraging, the experiment be repeated in other countries where local conditions are favorable.*

The Supplementing of Functions

Many of the proposals suggested in this report have significant manpower and staffing implications, both in Washington and in the field. Some may lead to a reduction in AID personnel; some obviously call for an increase. The proper implementation of the recommendations proposed here may require AID to create new posts, to be filled either by additional hiring or by transfer from existing positions. The Committee would urge, however, that when a position cannot be properly filled that it remain unfilled and that AID undertake to provide those services through another instrument. Accordingly:

> *We recommend that* AID *draw up a plan for staffing the recommendations proposed in this report, and that the Congress and the Executive Branch give sympathetic consideration to the* AID *proposals.*

The Need for a Continued Dialogue

The Committee firmly believes that the dialogue between AID and the private sector which the Committee's operations have helped to develop should be institutionalized and continued in the future. Some of the administrative suggestions made earlier will contribute to that objective. But more is needed.

The problems clamoring for attention at the topmost echelon of AID are many and complex. In the present organizational structure, even under the most propitious circumstances, the task of broadening the role of the private sector has to compete for attention with many other issues. To maintain an effective dialogue between AID and the private sector, one element that is needed is a clear point of effective contact within the AID organization—a man and office of sufficient stature to command the respectful attention of both the non-governmental organizations outside of AID and of the hierarchy inside of the United States aid organization. It is clear that extensive international experience outside of government, as well as experience in government, would be an indispensable requirement for the incumbent.

Finally, the Committee believes that other groups which are charged with evaluating the foreign aid program ought to have a continuing concern for the role of the non-governmental organizations in that program. We have in mind, particularly, the future operations of the General Advisory Committee for Foreign Assistance Programs, appointed by President Johnson in May 1965. We commend this critical subject to their continuing attention.

Arthur K. Watson

Ernest Arbuckle

J A Beirne

William T. Golden

[illegible]

Kenneth D. Naden

[illegible]

[illegible]

[illegible]

Appendix: Persons and Organizations Contributing to the Work of the Committee

Non-Governmental Contributors

Richmond Allen, Senior Economic Analyst, IBM World Trade Corporation
C. B. Baker, President, U.S. Steel International (N. Y.), Inc.
Robert C. Barnard, Cleary, Gottlieb, Steen and Hamilton
Stephen D. Bechtel, Chairman, Bechtel Corporation
Jack F. Bennett, Assistant Treasurer, Standard Oil of New Jersey
Louis Berger, President, Louis Berger and Associates
John Bliss, Stanford Research Institute
Donald A. Buzzell, Executive Director, Consulting Engineering Council
Sol H. Chafkin, Vice President, Checchi and Company
William Clark, Director, Overseas Development Institute
Emilio G. Collado, Vice President, Standard Oil of New Jersey
William Doherty, American Institute of Free Labor Development
James Dollard, Director of Education, IBM World Trade Corporation
Herbert A. Erf, Jr., Program Assistant, The Ford Foundation
John Fayerweather, Graduate School of Business Administration, New York University
John Gallagher, Vice President, Foreign Administration, Sears, Roebuck and Company
Jonathan Garst, Agricultural Economist and Author
Mireille Gerould, Editorial Researcher
Felix Ginorio, President, Amerconsult, Inc.
Harry E. Green, Vice President and General Counsel, The Container Corporation
James F. Greene, Vice President and Editor, Business International
Msgr. Joseph Gremillion, Director Socio-Economic Development, Catholic Relief Services

Paul R. Hanna, Lee L. Jacks Professor of Education, Stanford University

J. George Harrar, President, Rockefeller Foundation

Richard D. Harza, Vice President, Harza Engineering

Margaret Hickey, Vice Chairman, Advisory Committee on Volunteer Foreign Aid

Willem Holst, Vice President, Esso Standard Eastern

William G. Hotchkiss, Treasurer, International Division, Electric Storage Battery, Inc.

Harold H. Hutcheson, Economist, IBM World Trade Corporation

Robert S. Ingersoll, Chairman, Borg-Warner Corporation

Ronald K. Jones, Vice President, Overseas Promotion, First National City Bank of New York; New York Representative of ADELA

George Kalmanoff, Professor of Law, Columbia University Law School

A. M. Lederer, President, A. M. Lederer and Company

Henry Letoile, General Counsel, Perini Construction Company

Tom Lilley, Vice President, Ford International

Glenn C. Lucas, Attorney; former Institutional Development Officer, The Alliance for Progress

Edward S. Mason, Professor of Economics, Harvard University

Stacy May, Economist and Author

Rev. Daniel McClellan, Maryknoll Fathers, Peru

James McCloud, President, Industrias Kaiser Argentina

Francis McIntyre, Chief Economist, California-Texas Oil Company

Robert F. Meagher, Assistant Director, Public International Development Finance Project, Columbia University Law School

Max F. Millikan, Director, Center for International Studies, Massachusetts Institute of Technology

David Mitchell, Vice President, Chemical Bank New York Trust Company

Thomas P. Murphy, Managing Editor, THINK, IBM Corporation

Charles A. Myers, Professor, Center for International Studies, Massachusetts Institute of Technology

Norman B. Obbard, Executive Vice President, International, U.S. Steel Company

David Ogilvy, Ogilvy, Benson and Mather, Inc.

William Paddock, co-author of "Hungry Nations"

John J. Powers, Jr., President, Pfizer International

Michael J. Raffini, General Electric Company

Ralph W. Richardson, Associate Director of Agricultural Services, Rockefeller Foundation

William S. Royce, Stanford Research Institute

Seymour J. Rubin, Attorney; former U.S. Representative to the Development Assistance Committee of OECD

A. W. Shaw, Vice President, Bechtel Corporation

Nello L. Teer, President, Nello L. Teer Company

Elmo C. Wilson, International Research Associates, Inc.

Representatives of Foreign Governments and of Foreign and International Organizations

His Excellency Avrahan Harman, Ambassador of Israel

His Excellency B. K. Nehru, Ambassador of India

George Woods, President, the International Bank for Reconstruction and Development

Carlos Sanz de Santamaria, Chairman, The Inter-American Committee on the Alliance for Progress

Martin Rosen, Executive Vice President, International Finance Corporation

General Herbert D. Vogel, Engineering Advisor, The International Bank for Reconstruction and Development

Erwin Schuller, International Financial Advisor

John F. White, National Development Institute of Nicaragua

United States Government

The Congress of the United States

Senator J. W. Fulbright, Arkansas

Senator Jacob K. Javits, New York

Representative Frances P. Bolton, Ohio

William L. Saltonstall, Administrative Assistant to Senator Leverett Saltonstall, Massachusetts

The Executive Departments and Agencies

Orville Freeman, Secretary of Agriculture

David E. Bell, Administrator, Agency for International Development

Richard Reuter, Director, Food for Peace

Harold Linder, President and Chairman, Export-Import Bank

William S. Gaud, Deputy Administrator, AID

Floyd E. Dominy, Commissioner, Bureau of Reclamation

Donald Wilson, Deputy Director, United States Information Agency

Dorothy Jacobson, Assistant Secretary of Agriculture for International Affairs

Thomas Wyman, Assistant Secretary of Domestic and International Business, Department of Commerce

Milton Barall, Deputy U.S. Representative to the Inter-American Committee on the Alliance for Progress

Leona Baumgartner, Assistant Administrator for Technical Cooperation and Research, AID

Donald W. Hoagland, Assistant Administrator for Development Finance and Private Enterprise, AID

Herbert J. Waters, Assistant Administrator for Material Resources, AID

Glenn E. McLaughlin, Vice President, The Export-Import Bank

Lawrence McQuade, Assistant to the Secretary, Department of Commerce

John F. Hilliard, former Deputy Assistant Administrator, Office of Technical Cooperation and Research, AID

John W. Johnston, Deputy Assistant Administrator for Material Resources, AID

Donald B. MacPhail, Deputy Assistant Administrator for Technical Cooperation and Research, AID

Seymour M. Peyser, former Assistant Administrator for Development Finance and Private Enterprise, AID

Matthew Drosdoff, Administrator, International Agricultural Development Service, Department of Agriculture

Ralph Hirschtritt, Deputy to the Assistant Secretary for International, Financial and Economic Affairs, Department of Treasury

Erven J. Long, Associate Assistant Administrator for Technical Cooperation and Research, AID

Richard O. Loengard, Special Assistant for International Financial Matters, Department of Treasury

Robert L. Oshins, Director, Office of International Investment, Department of Commerce

Jack B. Kubish, Director, Office of Brazilian Affairs, AID

Rodney Wagner, Director, Office of Capital Development and Finance, Bureau for Near East and South Asia, AID

Wilbur L. Fugate, Chief, Foreign Commerce Section, Antitrust Division, Department of Justice

W. Gilbert Carter, Chief, Private Investment Division, Office of Development Finance and Private Enterprise, AID

Leigh M. Miller, Chief, Specific Risk Guaranty Division, AID

John G. Christy, Chief, Extended Risk Guaranty Division, AID

John Donley, Consultant, Department of Commerce

Richard Newberg, Rural Development Officer, USAID/Brazil

Organizations which Contributed Special Studies, Recommendations, and Information on Social and Economic Development

Private Organizations

American Management Association
Booz-Allen and Hamilton
Business Council for International Understanding
Chamber of Commerce of the U.S.
Committee for Economic Development
Development and Resources Corporation
Ford Foundation
International Finance Corporation
National Association of Manufacturers
National Industrial Conference Board
The Rand Corporation
Stanford Research Institute
U.S. Business and Industry Advisory Committee to the OECD
U.S. Council of the International Chamber of Commerce

Government Departments and Agencies

The Department of Agriculture
The Department of Commerce
The Department of Treasury
The Export-Import Bank of Washington
The Agency for International Development