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## New approaches to financing development aid

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### Overcoming the African "Independence Complex"

So far the fate of the proposals has not been decided and the final shape of the organisation is as yet utterly uncertain. Even so, the unusual activity of the African countries is worthy of note. Obviously the "Independence Complex" is being overcome much more rapidly than many had expected. This complex understandably stressed national identity and independence and often frustrated any—however sensible—collaboration with the former Motherland. The new proposals, moreover, demonstrate that these countries have acquired considerable national self-confidence which enables them to enter new paths of cooperation. It is certainly a surprise to many people that the Africans dare to take up old relations and ties. On the other hand, this may just prove that these countries today feel sufficiently independent to remember certain more or less uniform fundamentals established during France's colonial era and to use them as a basis for a future common policy.

In some places the project is, however, regarded as a desperate move by the African countries to counteract the noticeable tendency of France gradually to loosen its still close links with its former colonies

and to expand its interests in the field of international cooperation with the developing countries.

Thus the somewhat paradoxical situation has arisen of the former Motherland reacting with extraordinary reserve to appeals for collaboration with the African countries, perhaps partly out of fear that this might lead to new financial and political obligations. But there may be other reasons, too, why the project is a two-edged sword for France. Even if the idea is certain to meet the secret ambitions of many Frenchmen and although it shows what important influence France still or again has in many countries, official circles will hardly want to grant a certain group of countries priority in cultural and economic cooperation and then be charged with promoting a policy of imperialism or neo-colonialism. Besides, by acceding to these proposals France runs the risk of splitting the powers which on a less firmly fixed political basis might maintain closer relations with it than could ever be achieved by a new and open declaration of collaboration. France can scarcely be enthusiastic about that. It therefore clearly needs all its renowned diplomatic skill to handle this proposal for a rapprochement among the countries concerned—a proposal which is basically to be welcomed.

## New Approaches to Financing Development Aid

By Klaus Bolz, Hamburg

It will depend on our methods of dealing with the problems of development aid in the years to come whether Gunnar Myrdal's statement will maintain its deplorable topicality also for the last years of this decade: "On the late President Kennedy's proposal the sixties were declared to be the Development Decade. Half of that decade has now passed into history. It has been the history rather of a slowing down than of speeding up of development in most underdeveloped countries. Some of the most important of them seem to be heading for economic stagnation, some are actually falling backward."

In 1964 (1963) the developing countries' total capital receipts, i.e. subsidies and credits from public and private sources as well as from multilateral institutions, amounted to altogether \$ 9,700 million (9,300 million). About 90 % of all financial contributions are originating directly from OECD countries or from funds which these states have placed at the disposal of multilateral agencies. From 1961 to 1964 the OECD countries' public net contributions amounted to about \$ 6,000 million annually. If the developing countries' total receipts for 1964 have grown nevertheless, this is above all a result of the considerable increase of private capital contributions and the rise of net payments made by some multilateral agencies, who still have unused funds at their disposal.

The aid programmes of the Eastern bloc including China started in 1954 and including 1963 reached a

volume of \$ 5,300 million in the form of promises (mainly credits, but only \$ 1,900 million in cash).<sup>1</sup>

### Future Demands for Development Aid

Even assuming that the estimates of the well-known economist and expert on development problems, Fritz Baade, may show wide margins of error, the figure of \$ 20,000 million of annual capital aid for the objective of a 4 % increase of the national products per head of the population is indicating how far remote from sufficient aid we still are, or, respectively, to what dimensions we have to adapt ourselves in the next years. These \$ 20,000 million of capital aid or, including food and fertilizer aid, of \$ 25,000 to 30,000 million annually in about 10 years have to be contrasted with our present aids totalling approx. \$ 9,700 million per annum. According to the International Bank for Reconstruction and Development (World Bank) total Western aid would have to be increased by about 50 % in order to cover the developing countries' present requirements. Ever recurring fluctuations of raw material prices in the world market are to be emphasised as causes for the but comparatively minor success of development aid as carried through up to now—apart from planning failures, too unfavourable credit terms, corruption, and a rapid population

<sup>1</sup> OECD, Entwicklungshilfe — Politik und Leistungen, Jahresprüfung 1965, German edition (OECD, Development Aid Policy and Contributions, Annual Audit, 1965.)

growth. These price fluctuations together with the other factors are effecting a steadily growing indebtedness of the developing countries and their further economic disadvantage.

In the early stage of development policy many funds were wasted at first, because the developing countries' absorbing capacity was still limited due to the development level of their overall economy. This capacity to absorb and employ capital reasonably should have increased during the last years. As long as development is not increasingly self-sustaining, growing foreign funds will be required for the consolidation of new structures already established in certain sectors and for the further promotion of economic growth. A quantitative extension of development aid must be accompanied by easier terms in order that too high and too early repayments will not endanger the already realised objectives or development aid as such.

### The New Methods

Essential and new approaches are selected here for the description and assessment of new financial opportunities. For only two of the six methods analysed in this context, i.e. the Horowitz Plan and the study of the World Bank, due to their advanced reification, the term of "Plan" is justified. The hitherto still less accurately formulated approaches, the regulation of raw material markets, the International Development Association's (IDA) accumulation of funds, the reform of the international monetary order as well as the extension of the International Monetary Fund's (IMF) compensation payments call also for a short description and appreciation, since in various fields they are important for a judgement on both above mentioned "Plans".

The order of succession in the description of the six approaches is largely decided by their intensions. The Horowitz Plan, the reform of the currency system in favour of the developing countries, and a new increase of the IDA-fund mainly intend to advance the financial volume of development aid. True, this applies also to the World-Bank-scheme, the raw material agreements, and the extension of the IMF-compensation payments. However, these proposals tie up the financial benefit of development aid with the condition that a development plan, as first drawn up by the developing countries' governments without the funds supplied through these "three methods" must be jeopardised. Only in the case of losses of export proceeds this type of financial aid is becoming effective. The commodity agreements, however, are supposed to limit already the formation of deficits in export proceeds.

### The Horowitz Plan

The Horowitz Plan—named after the Governor of the Bank of Israel—is not so new. It has been brought forward during UNCTAD at Geneva in 1964. The discussion of its principal features is not yet over but presently is being revived once more. The scheme of this plan is to be described here in its main outlines: A flow of private capital from industrial countries is to be directed via a certain institution into the channels of development aid. In order to mitigate from the

very first the developing countries' increasing tendency towards excessive indebtedness, loans at market conditions raised in industrial countries are to be offered the developing countries on favourable terms. The differences in interest are to be borne by a fund to be supplied by the industrial nations. Moreover, according to this plan the industrial nations will be guarantees for a repayment of the loans in due time. Horowitz thus believes to mobilise some additional \$ 600 million annually, i.e. \$ 3,000 million within five years. He estimates the funds required for the necessary adjustment of interest to be \$ 120 million for five years and optimistically stated that small sums, compared to the ignition process of a motor, may result in a large effect so that with \$ 120 million one may mobilise \$ 3,000 million. Before approaching a realisation of this theoretically very clear and concise looking plan, some problems very important for practical purposes have to be reasoned out.

The idea of a guarantee cover by the industrial nations' governments and the formation of an interest-adjustment fund offers some difficulties for its practical realisation. According to which formula are the individual industrial nations to be engaged? Would it not be cheaper if the aid were organised bilaterally at favourable conditions by the governments of industrial countries? The funds could be raised privately on commercial terms in the country involved and its government would have to pay the difference in interest. Its economy as a whole would be charged both with the capital raised and the interest payments and guarantees.

According to the Horowitz Plan a combination would be conceivable in which some economies would supply the sum total of loans (private) and part of the interest payments (public authorities) while other countries would only supply the means for the adjustment of interest. In the case of small and comparatively weak economies this could be accepted as a good solution. In any other case the economies paying only interest would be charged comparatively little. Any plan favouring conflicts among the donors due to the economic overall burden, cannot on a long-term view, be a well-working instrument of development policy. After examining the Horowitz Plan, New York bankers arrived at the conclusion that possibly half of the capital raised additionally might be placed in the United States and Canada if their governments would accept full liability for the repayment of the amounts borrowed. Moreover, in connection with the Horowitz Plan there is a risk that the usual volume of loans placed by the International Bank for Reconstruction and Development might become more expensive than hitherto since interest increases could not be excluded. The other \$ 300 million could possibly only be raised at the expense of World Bank Loans placed in Europe.

The other problem, namely whether guarantees for periods of e.g. 30 years are deemed tolerable for industrial nations, seems to be particularly questionable owing to some countries' dilatoriness, their excessive indebtedness, and unstable political conditions. In each and every case the donor countries' governments would have to engage themselves very much indeed.

## Reform of the International Currency System in Favour of Developing Nations

Obviously the developing countries' governments are feeling that their interests and problems are being ignored in the international discussion of monetary subjects. The most recent statement justifying this conclusion is the "Declaration of Jamaica" made by the governors of the Latin American Central Banks who recently met on Jamaica. The conditions laid down by the International Monetary Fund also for developing countries the governors believe to be too rigid and doctrinaire, in some cases even obstructive to development. The developing countries are taking many initiatives on various levels whose results finally always lead to demands for reforms of the international monetary order which would be useful for them. Thus in 1965 an international group of experts (without the attendance of important Western currency experts) had met, hoping for even two considerable "presents" from the revision of the world monetary order:

1. A favourable consideration when creating additional international liquidity, and,
2. moreover, additional long-term funds.

This is the conjuring trick the group of experts fancies: The industrial nations pay their money into the IMF and get corresponding credit entries in international units of payment. Then the IMF could transfer the currency units obtained to the World Bank which in its turn might give them as soft loans to the developing countries. The international payment media created, amounting to the sum of inpayments, would be available above all for the task of promoting monetary co-operation, international trade, stability of currencies, and international balances of payments.

This plan which is supposed to offer the developing countries more "liquidity" and at the same time more "capital" is at present under discussion in different international institutions (World Bank, IMF, Club of the Ten).

For several reasons, this plan at first sight both captivating and intricate in spite of its tricks will meet with the industrial nations' resistance. For one thing Western monetary experts do not agree at all whether and to which amount international liquidity should be increased at all if all the countries would adhere to a reasonable balance of payments policy. For an-

other, the industrial nations defend themselves against a too excessive unilateral financial burden. Moreover, closer examination would be required whether this extensive creation of money would, among other things, not initiate inflationary circles which might back-fire and above all hurt the developing countries, if only through price increases of industrial goods in the most important exporting countries.

Even after intensive studies of the IMF's tasks and the way it operates, this suggestion appears to be indiscussible since for one thing it does not consider enough the regulations and intentions of the IMF, while for the other it does not develop clear ideas as to how the IMF is supposed to function if at the same time the expected "capital donations" are to be made available for the developing countries. The provision of these "donations" would basically change the functions of the International Monetary Fund. The IMF Articles of Agreement and its objectives do not permit that money of the above mentioned kind is given as long-term capital.

## Another IDA-Increase of Capital

Recently the International Development Association's fund received an allocation to the amount of \$ 75 million from profits of the International Bank for Reconstruction and Development (World Bank). Nevertheless, in order to satisfy the high future demand for means on favourable interest terms and with long periods to run, another increase of the fund cannot be avoided (last increase by \$ 750 million in 1964). Therefore IDA is again expecting cash from the industrial nations in order to be able to undertake further development projects under the conditions granted hitherto.

As long as it has not yet been cleared up what institutions will undertake the development programmes represented in this context, the fund increase of IDA looks like a very isolated measure. But as far as IDA is at the same time becoming the institution in charge of e.g. the Horowitz Plan or the World Bank scheme, there are points of contact with the other plans as regards the raising of funds and their employment. The desired public drawings on capital have an advantage in form: from the first no interest payments are being offered, therefore under this aspect no new conflicts will be precipitated as regards the raising and distribution of funds.



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## The Study of the International Bank for Reconstruction and Development

Requested by the United Nations Conference on Trade and Development the World Bank's staff has worked out a study on development aid.<sup>2</sup> The intended financial measures are to prevent the developing countries' development programmes from failure due to unforeseen deficits in export proceeds. From the first the appropriation of funds was tied up with the condition that the developing countries' "adequate expectations" of the extent of export proceeds are not realised and that short proceeds cannot be balanced otherwise on short term.

The staff of the International Bank for Reconstruction and Development has therefore recognised the present and future significance of a menace to the plan through not foreseeable deficits in export proceeds that cannot be eliminated short-term. The scheme recommended as a solution of this problem provides for an annual contribution of the industrial countries to the amount of \$ 300 to \$ 400 million, payable to an Agency. Assurances to pay these contributions should be given this Agency for periods of five years and most of them may be in the form of bills payable on sight, which, however, would have to be met promptly when required. The additional aid is intended to be dependent on strict criteria. Thus export proceeds that within a projection period surmount the anticipated receipts shall be used in the first line to balance deficits shown during the same period.

In order to guarantee a correct operation of the scheme the Agency and the developing country have to come to an understanding similar to a contract, which first of all is to comprise a projection of adequate expectations of export proceeds and a "policy-packet" guaranteeing a certain development policy to be undertaken by the developing country. Thus the financial projection will be an important part of the agreement but at the same time of one's own development plan. The agency may revert to the world-wide experiences gained by the World Bank for making the financial projection and the later supervision of the involved countries's development policies. With the various international development institutions it may also exchange informations on the contracting states. If a developing country deviates from the guidelines agreed on, it risks the loss of its claims for aid.

Two circumstances are promoting the belief in the scheme: While carrying-through their development plans the developing countries need not apprehend anymore such risks as caused by programmed but not realised export proceeds. Secondly the World Bank hopes to promote the international spirit of solidarity through co-operation as planned by the scheme and at the same time to stimulate the developing countries' own performance.

The Agency's right to a say in making the plan and the economic policy as provided for by the scheme, as well as the current controls, might nevertheless impress the developing countries as a new form of colonisation were their dearly beloved consciousness

of sovereignty not consoled with the fact that their representatives were collaborating in making as well as in executing the scheme.

A study of this scheme raises the question whether or not this perfect-looking scheme would not create extensive conflicts in its realisation. Above all the plan shows too much perfectionism as regards the prerequisites the developing countries have to supply: joint prognosis of expected exports, agreement on the "policy-packet" and the development programme as well as a previous full utilisation of all credit resources by the developing country. All the prerequisites mentioned might lead to tensions and with that to disturbances of the financing procedures if there are no additional safeguards. The efforts for avoiding any waste of funds might induce the Agency to persist too pronouncedly in its right to a say. Intending to cash in on as many funds as possible in case of an export deficit the developing countries will first exaggerate their expected proceeds and possibly also try to defend them against the experiences made by the World Bank and the other international institutions. Since the expected proceeds will become an important datum of the development plan, they enable its inflation. Likewise, conflicts over measures of economic policy are being promoted by the fact that the measures have frequently to be taken short-term due to changed circumstances and then might not correspond with the agreed guideline covering five years. The agency will press for a full utilisation of all other credit resources, the developing countries, on the other hand, will first demand the recourse to the Agency's funds in order perhaps to additionally dispose of other resources.

The intention of the scheme, unambiguously directed towards primary self-help, has positive and even educative effects as regards the avoidance of conflicts. The funds for safeguarding the development programme will only be spent if the developing country has made serious efforts for the removal of its financial troubles.

However, one gap has not been closed so far by the World Bank study. In case a country does not only show export deficits but at the same time has to pay high prices for imported capital goods the scheme does not guarantee the execution of the plan. Current discussions should come to an agreement as to this case, too.

The last word has hardly been spoken as regards the optimum utilisation of surplus export proceeds, for if during the whole period only surplus proceeds are occurring, it could not be advocated to freeze the funds as a provision for the balancing of possibly occurring deficits. Might there not under overall economic aspects a losing business develop from this? Should surpluses be invested, reserves be created, or money be lent to a fund?

Although many of these countries are already complying with the scheme and working out development plans, the elementary prerequisites of the latter are frequently still showing shortcomings. The targets are too ambitious, and domestic resources are overrated. Attempts at working out well-balanced plans jointly, with chances evaluated realistically, might precipitate conflicts between the Agency and the developing countries.

<sup>2</sup> International Bank for Reconstruction and Development: Supplementary Financial Measures, Washington, December 1965.

In its main points the World Bank's study proves to be a sober work directed towards economic success in development policy. Its serious intentions aiming at stability in developing countries will promote the donors' preparedness for offering additional capital in spite of negative experiences made in past years.

The scheme deserves a serious discussion and the majority of industrial nations is backing it. Britain, the Netherlands and Sweden want its detailed revision. The United States, Canada, Switzerland, and the Federal Republic of Germany consider it a useful basis for further discussions. France as usual is taking a separate position and wants to direct the main efforts towards raw material agreements. The East-bloc abstained from voting in the decisive meetings but also there no uniform frame of mind is to be noticed. Above all the Soviet Union would prefer the dirigist method of raw material agreements.

UNCTAD has already appointed a group of 13 to 15 governments to undertake further intensive studies. This committee will deal mainly with the above mentioned subjects meeting with criticism.

#### **Extension of IMF Compensation Payments**

The intention of this approach is comparable with that of the World Bank. Already since 1963 the developing countries have the opportunity of compensatory drawings on the IMF, above all in order to equalise balance of payments troubles caused by sudden fluctuations of export proceeds. When required, a further 25 % over and above the standard quota are at the disposal of the developing countries at favourable conditions. As already at the Trade and Development Board, now again amendments are being discussed by the member states. The additional share in the quota shall possibly increase to 50 %. The fund reserves required for this will amount to approx. \$ 300 to 400 million. The chances of a realisation are internationally considered to be favourable.

#### **Regulations of Raw Material Markets**

The proposals for comprehensive raw material agreements made by France for years come only indirectly within the terms of compensatory payments because they are supposed to avoid such a case from the very first. The aim of the market regulation- and price support activities is a stable system of high level raw material prices that guarantees the developing countries high export proceeds. This plan does not operate with credits and interest funds. Its execution seems to be much easier if the raw material agreement as such has been concluded. It would have to be expected that exclusively the purchasing countries, in conformity with the volume of their demand, would have to carry the burden of artificially increased prices. The indirectly granted allowances (difference between prices based on the agreement and those not) are definitely lost for the industrial nations, they possibly even do not stimulate the developing countries' activities in other production fields. Thus in the case of complementary financing through the World Bank the development programme will be assured and the economic development be promoted,

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but ultimately on a credit basis only, so that an effective stimulation of the developing countries' own preparedness for a good performance is conceivable.

According to all experiences in market regulations in the case of raw material agreements it will not be merely a question of price fixing on a high level. The industrial countries would have to commit themselves to make supporting purchases in order not to tempt the suppliers to leave the fixed prices. Certainly several hundred million of dollars would have to be spent for the purchasing of surpluses, their storage and utilisation. For these and other reasons most Western industrial nations are supposed to develop a distaste for such agreements.

#### **Concluding Comparison of Some Proposals**

A comparison of these approaches is not intended to design a new scheme but will only call attention to points of contact, overlappings, and combination possibilities. It also remains a speculation in so far as concrete public statements of the governments asked to supply the funds are hardly available as yet. Unambiguous priority decisions on further forms and purposes of financing are becoming absolutely necessary, since a simultaneous realisation of perhaps most decisions surely would overstrain the industrial nations' good will.

The Horowitz Plan does not stipulate for the appropriation of its funds either the conclusion of

a contract or a deficit in export proceeds. Thus the developing countries have the opportunity of reverting to funds provided for by the Horowitz Plan if they do not observe the Agency's conditions in accordance with the World Bank Study. For two reasons this possibility should be eliminated: 1. Funds of the Horowitz Plan might be blocked for an objective that is the task of the Agency, 2. the "educative" concern of the World Bank study would become ineffective.

The World Bank Study and the IMF compensation payments are aiming at the same purpose, for one thing it is a question of the elimination of deficits in export proceeds, for another a general problem of disequilibria in the balances of payments (crucial cause is the deficits of export proceeds). Since the World Bank Scheme stipulates that the developing country fully utilise all financial resources, the latter might possibly first revert to short-term IMF funds. When later the long-term character of the deficit in export proceeds becomes evident, the Agency according to the World Bank Scheme would have to intercede for payments made by the IMF. A consciously complementary operation of both plans is conceivable therefore.

IDA usually offers its funds for a term of 50 years, a 10 years period in which there is no redemption and a management charge of  $\frac{3}{4}\%$ . As long as interest payments and periods to run of the World Bank Scheme are not accurately fixed a comparison of both is of little informative value.

Comprehensive raw material agreements might obviate to a large extent the World Bank Scheme and IMF compensation payments, if doubts in the fields of competition and structure policies were not so serious, for if the raw material agreements operated satisfactorily, deficits in export proceeds would hardly occur anymore. As compared with compensatory IMF payments and the complementary financing of the Scheme raw material agreements conjure up the danger of an exaggerated expansion of supplies from single-crop farming or production of one good only. There is hardly any stimulation for the developing countries to diversify their supplies and to increase their own efforts.

The funds of the Horowitz Plan and the IDA-fund-increase are likewise favouring the financing of further development projects and are granted long-term at soft conditions. Should in addition IDA become the administrator of the Horowitz-Plan-funds, these means might almost be considered a special form of IDA-fund-increase would the conditions and projects to be financed not deviate.

The Horowitz Plan and the extension of the IMF are only little comparable as the IMF is directed towards short-term compensation while the Horowitz Plan aims at a long-term supply of capital.

### General Review

Although the individual financial programmes show various points of contact, i.e. they are overlapping or complementary, they themselves do not refer to each other. Theoretically almost all of them could be realised jointly as regards their construction. At present their co-ordination is the task of special com-

mittees, as e.g. the Committee on Invisibles and Financing of the Trade and Development Board who repeatedly has dealt with different proposals and will deliberate again soon on the study and the Horowitz Plan.

The burdens which the industrial countries have to anticipate from the realisation of several proposals cannot be registered accurately at present, however, the estimates should arrive at a sum total of some \$2,000 million. The World Bank has found out that today the developing countries could use approx. 50% of the present aid for additional economically reasonable investments. On July 5, 1966, also U Thant appealed for an additional development aid of \$3,000 to 4,000 million. If—considering the great inaccuracy of the above estimates—a comparison with the present demand is permissible at all, it becomes evident that also a fast and sympathetic realisation of the just discussed financial proposals cannot yet satisfy the demand.

The proposals are showing more or less clearly that a large share of the capital has to be provided for by the industrial nations' governments. According to the opinions of various experts the placing of the private loans as stipulated for by the Horowitz Plan should be quite difficult, too, so that in the case of its realisation also here budgetary donations or government credits would enable the most expedient solution.

The initiators of the proposals are to be blamed that they hitherto did not ponder enough on the possibilities of raising the funds (their chances of success).

In order to achieve an optimum economic effect for development with the available financial volume the Development Assistance Committee—the development policy committee of OECD—is devoting itself to the co-operation of capital resources apart from other tasks. It is to be hoped for that this committee will offer its experiences for the co-ordination of new proposals for financing.

The discussion of new financing opportunities should—perhaps just because of the difficult provision of means—treat all approaches as alternatives, however with the objective of the most efficient application. If one were to schedule the proposals according to the chances of their realisation, the World Bank Scheme, the extension of IMF-compensations, and the IDA-fund-increase would come out on top as comparatively solid and easily comprehensible solutions.

The other three proposals will probably still remain under discussion for a while. Among them the Horowitz Plan should be advocated by the majority of developing countries, as in its context the possibly bothering agreements with an administrative agency will not be required.

As regards the terms, the general statement is only possible at present that none of the six proposals stipulates high interest payments. Apart from the IMF compensations and the raw material agreements all proposals will grant long periods to run.

Various committees of the Trade and Development Board, the Bank for Reconstruction and Development, the IMF and others, will have to work hard to obtain practicable recommendations.