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## Targets, commitments and realities

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present everything seems to indicate that the existing protectionist tendencies will not decline in future but will rather increase still. Other nations' counteractions then to be expected would abolish the export targets.

### **Neglect of Domestic Rehabilitation**

It is common to all these measures that they do not eradicate the grievance of the balance of payments misery but confine themselves to a curing of balance of payments items in respect of which savings are to be hoped for soonest. But the United States' balance of payments troubles neither result mainly from exaggerated investments abroad and foreign credits, nor from too much tourism or too low exports. They are rather caused above all by the country's manifold economic and political obligations as a world power. A truly effective policy for the rehabilitation of the balance of payments ought to take these facts into consideration. Moreover, corresponding measures for a domestic rehabilitation are required for its supplementation. Only if the domestic situation allows for sufficient opportunities for profits, direct investments will be made in the United States in the long run and credits to a large extent will remain in the country. Stable prices are as well a most important prerequisite to a permanently effective export promotion policy.

The most recent tax bill and the plans for a reactivation of income policy should hardly suffice to achieve stabilisation as long as a vast government budget permanently initiates inflationary tendencies.

The measures planned now are to the disadvantage of the allies. Their effect is by no means secured. Besides it may be assumed that they will scarcely remain restricted to two years but like all protectionist interferences will show a tendency to stay.

This would not remain without influence on the future development of the world economy. For, after the United States for nearly 20 years advocated the ideas of free trade with an almost missionary zeal, in a case of emergency the country turned to measures of old-fashioned protectionism.

Thus the United States followed the example given by a growing number of other highly developed countries. In spite of all professions to the ideas of free trade and free capital movement, measures in conformity with free trade, that are difficult to operate, did not yet assert themselves. Johnson, too, adopted the easiest course with his new programme. The protectionist undercurrents—not so weak anyway in the Western world and particularly in the United States—will hardly weaken this way.

## **INTERNATIONAL AID**

# **Targets, Commitments and Realities**

by Professor Dr Hans W. Singer, New York \*

**B**y solemn resolutions of the United Nations, both in the United Nations themselves and in related organisations such as UNCTAD, the industrial countries of the world have accepted a commitment to provide aid to the developing countries of at least 1 per cent of their national incomes. It may be noted that this commitment was accepted, in voting at least, both by the Western and the Eastern group of industrialised countries. The Western industrialised countries have not only voted for this commitment, but they have further and voluntarily re-affirmed it in the Development Assistance Committee (DAC) of the OECD in Paris, and they are seeking and debating detailed ways of carrying out this commitment.

The commitment is impressive. It certainly represents a new departure in international economic relations, and most of us would welcome it as a sign of hope and promise.

### **Problematic Definitions**

However, a number of questions immediately arise. Most obviously, there is the problem of how to measure the target itself and its fulfillment. There are some

questions concerning the denominator of the 1 per cent ratio, i.e., the national income of the aid-giving country. There are several national income concepts—net income and gross income, domestic and national income, etc.,—developed by national accounts statisticians. These difficulties are, however, quite minor compared to the difficulty of measuring the numerator, i.e., the amount of aid given to developing countries. There, a minor difficulty arises in connection with the definition of "developing country". The OECD definition for example, differs from the United Nations definition. There are obviously borderline-cases. Is Greece a developing country? Is Israel? What about Spain and Portugal? However, the really important difficulties arise in connection with the definition of "aid". What is aid?

The widest possible definition of aid would make aid identical with all transfers of resources to developing countries. Private investment, export credits, aid to close military allies, commercial loans at 6, 7 or 8 per cent per annum—all would be included in aid. Moreover, a maximum definition of aid would measure aid flows on a gross basis, that is disregarding amortisation of previous resource transfers, let alone interest payments and reverse capital flows from the

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developing to the industrial countries. As recent studies have shown, these reverse capital flows, including particularly, flight of capital, are by no means inconsiderable. The OECD in its measurement of aid, and also the UN, come pretty close to this broad definition of aid, including all resource transfers regardless of terms and conditions. They depart from the maximum definition, however, by taking aid usually net of amortisation of previous aid.

A minimum definition of aid would include only straight gifts or grants plus the gift value of aid transactions which are partly gifts and partly commercial, so-called "soft" loans. This is the "Pincus Formula", by which aid is defined and measured as the value of what is being given now, minus the present discounted value of the future repayment obligation. The difficulty with the Pincus formula is twofold: (a) the future repayment obligation may not be precisely firm, as in the case, for instance, when a loan to a developing country provides for postponement of payment when export proceeds drop or for consultations between creditor and debtor in case of difficulties etc.; and (b) for purposes of discounting future repayment obligations in order to obtain present values, we must select a rate of interest, and different rates of interest selected for this purpose, will strongly affect the result. In spite of these, and other difficulties the Pincus formula is now generally recognised by economists and analysts as conceptually the correct one if we want to measure real aid, as distinct from the *quid pro quo* of lending and borrowing which resembles trade rather than aid. International organisations, however, in their basic publications and measurements have so far mainly adhered to the broader resource transfer concept.

It is quite clear that under the narrower gift concept of aid through the Pincus formula, private investment is almost totally excluded by definition. Even for public transactions the use of the narrower definition reduces the result considerably. Thus when the Pincus gift formula is applied to the official OECD data of aid to under-developed countries, the total is reduced from \$ 7.7 billion to 4.7 billion in 1962, a reduction of 40 per cent.

#### **Problems of Measuring Foreign Aid**

Our problems of measuring foreign aid to developing countries are by no means over when we have chosen between the broader resource transfer concept and the narrower gift concept. We still have problems of valuation. For instance, should the value of goods delivered as aid or for aid projects be valued at the domestic prices of the aid donor or at world market prices? This will make a very considerable difference. To illustrate, an important element in aid consists of food aid, principally from the United States under Public Law 480. Officially the value of this food aid is measured by the domestic United States price of the food involved. However, the United States domestic price for food is very much higher than the world

market price, since it is artificially raised and maintained in order to help the American farmer. (The same is of course true for practically all other Western aid-giving countries, with the exception of Great Britain, which uses different methods of subsidising its farmers.) It makes a great deal of difference to the aid total if the food is valued at the lower world market price, as it probably should be. Even then we are not completely out of the woods, because it could quite plausibly be argued that the world market price itself would be a lot lower if the available food were not artificially kept out of the world market and distributed as food aid. Thus it can be argued that if the developing countries did not get food aid and the food were instead commercially available, then the world price would drop and the developing countries, insofar as they are importers of food would save money on the import bill, and thus these savings should be set off against the nominal value of the food aid. For those developing countries which are exporters of food, the argument would apply in reverse: they benefit from the higher world market price as a result of food aid, although in the aid statistics they would not be counted as recipients of aid on this account.

#### **The Tying of Aid**

The problem of valuation of aid is so serious and all pervading because it is tied in with one of the major factors inhibiting the effectiveness of aid. I refer to the fact that practically all bilateral aid—and hence the bulk also of total aid—is tied aid. In fact most of the aid is double-tied, both tied to commodities from the specific aid-giving country only, and also tied to specific projects which the aid is designated to finance. This double tying of aid is perhaps the most serious single factor at the present time which reduces the value of the aid to the recipient below its nominal value or cost to the donor. Moreover, the tying of aid by the individual national aid programmes is largely self-defeating. If German aid to India is tied to German equipment for a German-aided project, when British equipment would be cheaper and more effective, while at the same time British aid to India is tied to British equipment for a British-aided project when German equipment might be more effective and cheaper—then it stands to reason that in the final analysis neither Germany nor Britain will benefit. But the real sufferer is India which finds the effective value of the aid reduced by tying. Or perhaps we should add that the real sufferer might also be the German and British taxpayer who could be asked to put up less money for aid to India, and yet help India as effectively as now, if only the aid could be untied by agreement. This situation is obviously absurd and calls for either agreements among bilateral donors of aid to abandon tying, or else a shifting towards multi-lateral aid which should by definition be untied. A particularly harmful aspect of aid tying may be seen in the example of a USAID financed irrigation project in Thailand, in which the best or cheapest equipment might have well come from India. Yet under tied aid,

US equipment may have to be used, hurting India even though at the same time US aid money is flowing into India. The case for exempting at least the developing countries themselves from tied aid restrictions is very strong.

It is true, of course, that the worst effects of tying of aid in reducing the real value of the aid to the developing recipient may be avoided by efficient arrangements within the aid consortia which exist, for instance, for India and Pakistan. This can be done by reserving for, say, German aid to India the type of project in which German equipment is likely to be most competitive, and correspondingly for the other aid programmes. However, in practice this does not go very far in offsetting the disadvantages of tied aid. Although detailed data are sadly lacking, the best study on this subject which relates to Pakistan has shown that the loss in value of aid is very significant, probably of the general order of 25 per cent or so. Pakistan, it may be noted, has an aid consortium. It should be remembered that in the case of tied aid the very knowledge on the part of the firms in the aid-donor country i.e. that firms from other countries are not allowed to compete and submit tenders for equipment for the aided project will raise prices by removing competitive pressures. To summarise: most of the aid is tied or double-tied, and such tied or double-tied aid tends to be over-valued when it is taken at its face value, since it represents a lower real value of aid to the recipient.

The 1 per cent standard for aid raises other questions as well. Should the trade behaviour of industrialised countries be left out of account? In matters of trade, the record of the various industrialised countries differs considerably: Great Britain, for instance, imports much more on a per capita basis, or as a percentage of its total imports, from the under-developed countries than the European Common Market. Should not the European Common Market countries therefore give more aid than Great Britain since they give less "aid through trade"? Trade in the aggregate is still much more important to the developing countries as a foreign exchange earner than aid. Their total exports now run at approximately \$32 billion per annum, while aid even on wide definitions is not more than \$8 to \$9 billion per annum. Potentially, trade concessions might be more important than additional aid to the developing countries. A comparison of two countries merely and entirely on the basis of the percentage of their national income which they designate as aid can be highly misleading.

#### **Measuring the Aid-Giving Capacity**

Another problem arising in this connexion with the 1 per cent standard may be formulated in this way: is the national income really the proper and sole standard for measuring the aid-giving capacity of an industrialised country? There are some obvious doubts relating to such high income countries as Canada, Australia, New Zealand, which are themselves in many relevant respects "developing countries"—certainly in the sense relevant in this context that they

are heavy capital importers, rather than capital exporters. But quite apart from these cases, there is the problem of the balance of payments situation. Should a country with a balance of payments surplus be expected to give more aid than another country with the same national income, but a balance of payments deficit? The practical politicians and parliaments of the aid-giving countries will probably answer without hesitation in the affirmative, at least in the sense that a balance of payments deficit should be considered a valid reason for cutting down on aid. However, to an economist looking at the aid picture as a whole, the answer is by no means so clear. The under-developed countries basically do not cause any balance of payments deficit for the industrialised countries, since they tend to import roughly to the limit of their available resources, and (except occasionally and to a limited degree) they do not build up foreign exchange reserves. It follows that if a specific industrial country A has a balance of payments deficit, then another industrial country B must have a balance of payments surplus. Thus the balance of payments deficits of specific countries should not be an argument for reducing total aid to developing countries.

#### **Beginning of International Taxation**

Finally, if we consider the aid commitment of 1 per cent of national incomes as the beginning of international taxation, obviously an identical tax rate of 1 per cent across the board is an extremely crude form of income tax. In our national income taxes, we have all adopted the progressive system under which the rich pay not only absolutely more, but also a higher percentage of their incomes. This should also apply internationally. Among the aid donors, Japan, for instance, or Italy are poorer than the US. If 1 per cent is right for Japan it is too low for the US; if it is right for the US it is too high for Japan. This can of course be partially answered by pointing out that the 1 per cent is not a maximum but a minimum which a richer country would be expected to exceed. However, the current discussion and the current facts do not point in that direction. With the possible exception of France, no aid donor country is anywhere near the 1 per cent target. Moreover, in the last five years or so we have been moving away from the target. In a sense, this situation enables us to disregard many of the points discussed in this article. One could say: "Why worry about all the problems concerning evaluation of aid, definition of aid, untying of aid, softer terms for aid, etc., since we are nowhere near 1 per cent and are slipping back even on the widest definition of aid. Why not first bring ourselves up to 1 per cent on the widest definition of aid and then start worrying about the finer points?" This sounds plausible, but would be short-sighted. It is a good sign that the DAC of OECD has taken that line, but that a lively international discussion on softer terms of aid, untying of aid, valuation of aid, etc., has in fact resulted. Perhaps this is the most useful and directly tangible result of the 1 per cent target.