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ECONOMIC POLICIES TOWARD LESS DEVELOPED COUNTRIES

SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

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ECONOMIC POLICIES TOWARD LESS DEVELOPED COUNTRIES

STUDIES PREPARED BY RAYMOND F. MIKESELL AND ROBERT LORING ALLEN

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LETTERS OF TRANSMITTAL

NOVEMBER 17, 1961.

To the Members of the Joint Economic Committee:

Transmitted herewith for use of the Joint Economic Committee and other Members of the Congress is a study paper prepared for the Subcommittee on Foreign Economic Policy, titled "Economic Policies Toward Less Developed Countries."

It is hoped that this paper will be especially useful to the members of the subcommittee and to the witnesses who will be testifying before the subcommittee later this year.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

NOVEMBER 17, 1961.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress,
Washington, D.C.

DEAR MR. CHAIRMAN: I am transmitting herewith a study paper titled "Economic Policies Toward Less Developed Countries," which has been prepared in the Institute of International Studies and Overseas Administration, at the University of Oregon, by Raymond F. Mikesell and Robert Loring Allen.

Both authors are professors of economics at the University of Oregon. Dr. Mikesell was formerly a senior staff member of the Council of Economic Advisers, and during the past year has served as consultant to the State Department and to other U.S. Government and international agencies concerned with foreign aid and investment. Dr. Allen has also served in several Government posts and previously participated in the Joint Economic Committee's studies on "Comparisons of the United States and Soviet Economies." Both authors have written widely on several aspects of foreign economic policy.

At the beginning of this Congress the Subcommittee on Foreign Economic Policy was asked to undertake a comprehensive examination of our foreign economic policy. To assist the subcommittee in fulfilling this assignment—and also for the benefit of other Members of Congress, the public, and particularly the witnesses who will participate in the forthcoming hearings—I have invited a number of scholars and distinguished experts to prepare study papers. The present study paper is one in this series.

Sincerely,

HALE BOGGS,
Chairman, Subcommittee on Foreign Economic Policy.

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PART I

INTRODUCTION AND CONCLUSIONS[1]

A. NATIONAL GOALS AND FOREIGN ECONOMIC POLICIES

Nations and civilizations have risen to great heights of accomplishments more by the glory of achievement than by the negative desire for self-preservation. Except in the face of an immediate threat to their security, broad popular support for national or community goals must be based on the promise of positive achievements which capture the imagination and provide a desire for identification with a movement embodying the loftiest ideals of which mankind is capable of holding.

While our national goals in the field of foreign economic policy must be related to our social and political well-being as a democratic nation, we do not believe that they can be couched merely in terms of anticommunism or national preservation. What is needed therefore, are positive objectives which will encompass both our interest in the preservation of our traditional freedoms and way of life as well as our interest in helping the rest of mankind achieve economic and social progress.

Political developments in the United States as well as in other countries have forced national governments to assume a responsibility for economic progress and welfare for the Nation as a whole. Similarly, international political developments are forcing the more opulent nations of the world to assume an international responsibility for social and economic progress, the equalization of opportunities, and a reduction in the disparities in levels of living among members of the non-Communist world.

The need for revising our foreign economic policy goals

U.S. foreign economic policies and programs frequently engender more than a minimum of controversy, not alone at home but to our consternation, in countries which have the most to gain by them.

Too often we justify a particular foreign economic policy or act to ourselves by pointing up how superbly anti-Communist it really is and how it will help us win the cold war. To the underdeveloped people who are on the receiving end, we justify the same act by telling them how it will raise their standard of living. The echo of the American debate is ringing in their ears and they wonder how sincere we are—whether we are not just trying to buy them off.

Why should we be ashamed to admit that we are concerned, and deeply concerned, with the well-being of mankind? Why should we try to obscure the simple truth that our well-being is dependent upon the well-being of others?

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[1] Pt. I has been prepared by Raymond F. Mikesell, professor of economics, University of Oregon. It sets forth the basic rationale underlying the entire study and summarizes the conclusions found in the papers on specific aspects of economic policies toward less developed countries, which constitute pts. II, III, IV, and V.

In truth there is no reason why we cannot be more honest with ourselves. And as we become more honest with ourselves, those parts of the world that are looking to us for leadership will have more faith in us and, indeed, recognize our singular beneficence to the whole world. As we become more honest with ourselves, it becomes easier for us to define our goals, both national and international. It becomes less difficult for us to compete with other economic and social systems. We will be striving for objectives and not merely working against something we don't like.

In considering any revision of American foreign economic policies and goals, it is fair to begin by accepting the fact that nationalism at home and abroad is the world's strongest motivating force. Against this we have to recognize that our goals as a leader nation are international in character. We cannot, therefore, avoid conflicts within ourselves since our concerns and loyalties go beyond our borders. Today, West European nations are seeking to solve similar conflicts through close economic integration which may ultimately bring about political integration among the European Economic Community countries. For their own good, West European countries are thinking more and more in terms of European community interests rather than in narrow national terms.

Whether we like it or not, today the United States is a part of the whole Inter-American Community. Whether we like it or not, the United States is also a part of the Atlantic Community. We are going to have to think and act more in terms of community as opposed to purely national interests.

In 1947 the American public and Government became thoroughly alarmed at the possibility that all or much of Western Europe might be taken over by the Soviet Union, and a truly gigantic effort was made to create a strong Western Europe as a bastion against further Soviet encroachment. Here was a national goal which became identified with a kind of loyalty to Western civilization as well as with our own national security. Definitive plans for the achievement of this goal were prepared together with quantitative estimates of both the economic costs and the economic results to be expected within a definite time period. Because of the nature of the governments in power in Western Europe, the relationship between the economic objectives and the political or basic national security objectives were reasonably certain. Our goals were achieved.

In the earlier postwar period, just prior to the cold war, the revulsion to war led to a widespread popular demand for the creation of international instruments, both political and economic, to avoid future wars; but soon disillusionment with U.N. machinery, both political and economic, set in.

The Korean war and the establishment of NATO laid the groundwork for the creation of a strong Atlantic Community. Unfortunately, we missed the boat with NATO. Its orientation was far too narrow—largely militaristic and we failed to see that Western security is intimately tied to political and economic developments not in Europe alone, but in the world as a whole. More and more our foreign economic objectives became obscure and complex. Unlike the Marshall plan of 1947 they have lacked definite targets to be achieved over a given period of time.

America's shifting position as a world power

In the 16 years since World War II, the problems of leadership and of action on the economic, military, and scientific fronts for maintaining the strength and independence of the free world have become far greater and more complex, while the relative power position and capabilities of the United States have declined rapidly.

Our military, political, and economic qualifications were at the highest when we assumed our leadership role in the late 1940's. At that time we had a monopoly in the field of nuclear weapons, we were the only surplus area for a large number of commodities desperately needed by the rest of the world, and politically we were still in the postwar honeymoon, relatively unmarred by the animosities that the exercise of political leadership itself inevitably creates. Our position has changed enormously over the past decade, and the next few years are likely to witness an even greater diminution of all facets of our power vis-a-vis, not alone the Sino-Russian complex, but the rest of the world as well.

Our nuclear monopoly left us in 1949. Our economic supremacy has also been whittled down. Our competitive position in world markets is being challenged as never before, frequently by those countries whose postwar recovery we guided and financed. Our greatest economic challenge, of course, comes from the Sino-Soviet bloc.

As we face the above truths, we must recognize our new role. *Today we must move from a position of free world leadership based on an overwhelmingly predominant military and economic posture, to a position of leadership based largely on such qualities as initiative, persuasion, skill in organizing and coordinating programs involving a number of countries, and above all, on confidence and respect for our integrity as a free world leader.* If we are to play this role, there must be an awareness on the part of our leaders and on the part of the public generally that very often what we do at home speaks louder than what we say to the world.

B. THE NATIONAL INTEREST AND DEVELOPMENT ASSISTANCE

It is our view that economic assistance to developing countries must be based on long-range political, social, and moral considerations. Development assistance should not be directed toward the achievement of relatively short-term political objectives.

Any effective aid program must be guided by the political and social as well as the economic environment within the host country. Thus, for example, substantial technical and financial assistance for land reform or the creation of credit institutions for strengthening small industries and farms may represent a more effective use of our aid resources than, say, a hydroelectric dam. Moreover, eliminating government corruption in a particular nation might prove more vital to progress than a rise in total output per capita.

The political and social problems facing our foreign aid institutions have been set forth exceedingly well by a recent study entitled "Economic, Social, and Political Change in the Underdeveloped Countries and Its Implications for U.S. Policy," prepared by the Massachusetts Institute of Technology Center for International Studies, for the Senate Committee on Foreign Relations (Study No. 12, Mar. 30, 1960).

This study points out that there are two strong opposing forces operating in most of the countries we are seeking to assist: (1) those arising from groups deeply committed to the traditional society and who fear that modernization and change will deprive them of the power, income, or security afforded by their traditional way of life; and (2) those from groups which have felt shackled by traditional society, who are seeking to become the new elites and who welcome rapid change as a means of broadening their own opportunities and enhancing their position. In the face of these forces, the MIT Center study concludes that it is to our interest to follow a middle course.

> Put in its briefest form, it is in the American interest to use such influence as we have to maximize the attractiveness and feasibility of the third choice: to help make the evolutionary transition to modernization successful enough so that no major group will opt either for regressive efforts to repress social, political, and economic change or for extremist measures to promote it (p. 62).

Suggested targets for economic development

Specific or quantitative goals for economic and social development can only be determined for individual countries, and their realization will depend very largely on the efforts of the governments and the people of the countries themselves. Nevertheless, it is desirable that the United States in collaboration with other economically advanced countries establish certain specific goals or targets which they are prepared to support by means of external financial and technical assistance, provided the less developed countries take the necessary self-help measures.

The announcement of specific targets would provide a basis for economic planning in the less developed countries, establish standards for evaluating proposals for economic assistance and for estimating probable magnitudes over a period of years, and give to the underprivileged peoples of the world concrete assurances of our willingness to join with them in the realization of their economic and social aspirations. It is suggested that these targets might include the following:

1. The elimination of hunger in all countries of the free world willing to cooperate in a joint program involving the expansion of domestic production and a temporary provision of food supplies from external sources, within a period of 5 to 10 years.
2. The virtual elimination of epidemic diseases and the achievement of minimum standards of medical care by all free world peoples within 10 years.
3. Universal elementary education and a reasonably high proportion of the children of all free world countries enrolled in secondary schools and colleges, to be achieved within a period of 5 to 10 years.
4. A minimum annual rate of increase in output per capita of 2 percent in all cooperating countries, to be achieved within a period of 10 years.

Additional specific goals could be added to these. For example, in many countries a broadening of individual opportunities would need to include land reform. Underlying all of these specific goals would

be the broader goal of creating the conditions in each country for human freedom, democracy, orderly legal processes, and the desire to work for world peace and understanding.

It should be noted that a number of specific targets similar to those mentioned have been established by the Alliance for Progress Charter for Latin America. Similar objectives might well be agreed upon for all developing countries of the free world.

In establishing and promoting these goals we would, of course, need the full cooperation and support of the other members of the Atlantic Community. These might very well be adopted as the major goals of the Organization for Economic Cooperation and Development. The implementation of these targets will require gigantic programs, large sacrifices, and enthusiastic support at all levels of society. The response of the underdeveloped countries to the announcement of the target goals would be very important, and careful consideration should be given to their reaction based on full consultation with representatives of the less developed countries.

Creating popular support for world economic goals

But on what basis might broad popular support for these goals be obtained in the United States and in other Western countries? First of all, the point must be driven home that if Western civilization is to survive, it cannot stand still, and that the basic social values embodied in the concepts of democracy and human freedom must be adopted by the vast bulk of the world that has never known them. Democracy and human freedom are not being challenged in most of the poorer countries of the world. They have never really existed. It must be made abundantly clear that unless the poorer two-thirds of the free world solve their social and economic problems by means which avoid totalitarian methods of Communist China, our way of life is not only in danger of withering away, but we will have missed a great opportunity for determining the course which civilization will take for many generations to come.

An appreciation of the history of the rise and fall of civilizations must somehow be driven home to people; that civilizations grow on achievement and that no Maginot line will save them when they stop growing. To borrow a phrase from Mark Twain, we cannot continue to look at the world "with the calm confidence of a Christian with four aces." We must somehow drive home the idea that there are two basic principles according to which human society may be organized: The totalitarian system of Orwell's "1984," and a dynamic, adaptable system which seeks to deal with the problems of social organization and human wants and aspirations, on the principle that the individual is the end and not merely the means, and that the primary goal of government is the enlargement of human freedom and opportunities.

National leaders cannot secure popular acceptance of, and enthusiasm for, these goals alone. We must develop a crusade for achieving these goals which will be adopted with almost religious fervor by civic organizations, churches, educational institutions, and by labor and management groups.

C. NEED FOR AN INTEGRATED APPROACH TO ECONOMIC DEVELOPMENT ABROAD

A major indictment of our approach to the problems of the less-developed countries in the past is that it has been piecemeal. We tend to think of these problems in terms of more or less separate compartments such as the need for (*a*) foreign capital, (*b*) technical assistance, (*c*) larger export markets, (*d*) stable export prices, (*e*) social reform, and (*f*) strong governments capable of preventing internal Communist subversion.

This compartmentalization is reflected in our programs and policies with respect to the developing countries. For example, there is a tendency to regard trade and aid as alternatives rather than as complementary or interdependent means of promoting development. This attitude is well illustrated by section 602(d) of the Foreign Assistance Act of 1961 which places limitations on U.S. Government assistance for those enterprises in developing countries which compete with U.S. products.

The people of the United States and Europe and their governmental representatives have failed to understand that import restrictions on the products of low-cost foreign labor are incompatible with economic assistance for achieving growth on a self-sufficient basis. Nor have we looked at the problem of export commodity stabilization in terms of the need for long-term structural adjustments in world production and trade. And most serious of all, our aid programs and trade policies in the past have not been integrated and directed toward the achievement of our basic long-range political and social objectives in the individual developing countries. We cannot understand why, after large outpourings of aid, there occur political developments in the recipient countries which we consider antithetical to our foreign policy interests and to those of the free world generally. We have failed to relate what the social scientists have been telling us for years about political pressures and social conditions and attitudes within countries on the one hand, and the specific goals of our development assistance programs on the other.

Part of our difficulty in analyzing and dealing with the basic economic, social, and political problems of individual countries and regions in a comprehensive rather than in a piecemeal fashion lies in the organizational structure of the complex of national and international agencies concerned with trade and economic assistance. In addition to a score of industrialized countries providing various types of economic assistance to the developing countries, there are a number of international and regional economic assistance agencies plus several international or regional agencies such as the GATT and the European Economic Community which are concerned with trade policies affecting the developing countries. In addition, there is the new Organization for Economic Cooperation and Development (OECD) and its Development Assistance Committee which are concerned with both trade and aid in relation to developing countries. But in viewing this multitude of free world agencies, both operating and policymaking, the activities of which affect the welfare of the developing countries, three things are evident:

(1) The absence of a set of clearly defined free world goals on which all countries, developed and underdeveloped alike, can

agree, and which would capture the imagination and kindle the hopes of all peoples who are free to express their feelings.

(2) The absence of coordination among these national and multilateral agencies in the field of both trade and aid alike, for a concerted effort for realizing agreed goals in the developing countries.

(3) The absence of coordination of the activities of various agencies operating in the individual developing nations at the country level.

In considerable measure these three requirements have been met by the Alliance for Progress program for Latin America. Perhaps this program could serve as a model for a program which would encompass the members of the OECD and all developing countries outside the Sino-Soviet orbit.

While emphasizing the interrelations between economic policies affecting the developing countries, and the need for a comprehensive approach, particularly at the individual country level, we must analyze the problems and consider recommendations in terms of traditional categories and instruments for dealing with these problems. In the following paragraphs, we shall summarize briefly the major conclusions of the individual papers dealing with (1) commercial policies, (2) commodity stabilization, (3) public development assistance, and (4) private foreign investment, which constitute the bulk of this study.

D. COMMERCIAL POLICIES AFFECTING DEVELOPING COUNTRIES

United States and West European commercial policies have reduced the potential export earnings of developing countries. This has been most evident in the case of agricultural commodities such as cotton, meat, and wool which have been subject to import restrictions or other discriminatory treatment such as the subsidization of domestic production. Western European countries have also imposed heavy duties for revenue purposes on commodities such as coffee, tobacco, and bananas. Latin American and other countries that are outside of the group of countries associated with the European Economic Community (or perhaps an expanded community which may take in certain British Commonwealth countries) will shortly begin to feel the pinch of tariff discrimination on such products as coffee, cocoa, and bananas. U.S. import quotas on lead, zinc, and petroleum and U.S. export subsidies on cotton have certainly had an adverse impact on the exports of certain developing countries. In addition to quotas and duties on certain raw material imports, we have imposed high duties on semiprocessed commodities such as refined metals. Moreover, many of the manufactured and semimanufactured commodities which developing countries would find it easiest to produce for export to world markets on a competitive basis tend to be subject to especially high duties or quotas in the United States and Western Europe. Thus, developing countries are discouraged from directing their manufacturing activities to production for world markets.

A major difficulty faced by most developing countries today is that the present and expected future rate of growth of their export proceeds is less than the rate of increase in their foreign exchange requirements

to meet their essential needs for capital goods, raw materials, fuel, debt and foreign investment service payments, and other goods and services. This is not merely a matter of these countries living beyond their means. Rather, it is a matter of their being unable to earn, through exports, sufficient foreign exchange to provide for a volume of imports consistent with a reasonable rate of economic growth. Recent studies of the longrun growth in demand for primary commodities indicate that developing countries as a group simply cannot earn sufficient foreign exchange to support an acceptable rate of economic growth without broadening their export base to include manufactures and semimanufactures. Thus far, developing countries have been seeking to industrialize almost entirely on the basis of supplying their limited domestic markets. This must change for two reasons. First, developing countries must broaden their export base if they are to earn the foreign exchange necessary for growth; and second, they must specialize, and hence export, as they move into higher stages of industrialization since their own domestic markets for many commodities are too limited for economical sized plants. To some extent this problem can be dealt with by the creation of customs unions and free trade areas, such as the Latin American free trade area, among the developing countries. But for many countries a customs union may, for one reason or the other, not be feasible and they must export to world markets in competition with the products of industrially advanced countries.

The General Agreement on Tariffs and Trade has not provided a suitable instrument for dealing with the trade problems of the less developed countries. The GATT establishes general rules against the use of quotas and export subsidies, but then provides for broad exceptions for the employment of quotas and export subsidies with respect to primary commodities. This has tended to work against the interests of the less developed countries. In fact, the main contribution of the GATT has been in reducing trade barriers on commodities exchanged by the industrially advanced countries, but the less developed countries have gained little advantage from these tariff reductions, many of which do not apply to the manufactures in which the less developed countries might be competitive. What is needed is a more positive approach involving a cooperative solution to trade problems affecting the national interests of a number of countries. It is not enough to have an agreement which states in effect that all interference with freely competitive forces is wrong in principle, but that because of extenuating circumstances, individual countries are free to violate the principle.

Recommendations

(*a*) The U.S. Government should take full account of the impact on developing countries in placing quotas or special restrictions on all primary commodities including agricultural, minerals, and petroleum. Where import restrictions are deemed essential for adjustments in domestic production or for national security reasons, restrictive actions should not be taken unilaterally, but rather as a part of an agreement reached with all exporting countries whose interests are concerned. This same principle should apply in all cases where the U.S. Government is subsidizing, directly or indirectly, exports of agricultural commodities in competition with the products of less developed

countries. Agreements should be reached through the GATT or through the OECD whereby all industrialized countries will adopt the principle of not employing quotas or export subsidies on primary commodities except under the terms of a multilateral agreement.

(*b*) In promoting economic interests of less developed countries, the United States should be prepared to modify two important principles which characterize its present commercial policies. First, the principle of avoiding tariff reductions which threaten serious injury to domestic producers should be abandoned, particularly where reductions in trade barriers will expand the markets of the products of less developed countries. Second, the principle of reciprocity, which requires that the United States receive trade concessions from other countries as a condition for liberalizing our import policies should not be applied to developing countries. There may be occasions when the United States will find it expedient to liberalize imports from less developed countries to a greater extent than it desires to liberalize with respect to the same commodities from industrially advanced countries. However, any exceptions to our traditional most-favored-nation policy should be restricted to measures for broadening the markets of the underdeveloped countries, taken in concert with other industrialized countries and in accordance with multilateral agreements among all countries whose interests are affected.

(*c*) The United States should seek an agreement with the countries of Western Europe whereby tariff preferences arising out of the European Economic Community would be made available to the products of all less developed countries.

(*d*) Customs unions and free trade areas among developing countries should be actively encouraged and assisted by the United States and other OECD members. However, an effort should be made to promote agreements among two or more regional trade associations of less developed countries for eliminating discrimination among themselves and broadening the market for their exports.

(*e*) The impact on the U.S. economy of the recommendations for broadening the export markets of the developing countries will be small, but certain industries and firms may suffer. The principles embodied in the escape-clause and peril-point provisions of our Reciprocal Trade Agreements Act should not be applied to these situations. Since broadening the trade opportunities for less developed countries is every bit as important as the provision of billions of dollars of economic assistance for promoting their growth, we cannot shy away from the cost of the impact which may be borne by a small section of our economy. However, the cost of adjustment should be shared by the U.S. economy as a whole through the institution of a liberal trade adjustment program. Such a program might involve low-interest loans to enable firms damaged by import competition to reduce costs or shift to other lines of production. In other cases the government might facilitate no-loss liquidation and provide for retraining and relocating workers.

E. COMMODITY STABILIZATION

(1) The United States and other industrial countries should adopt as a basic policy goal: (*a*) The prevention of, or compensation for, sharp fluctuations in the export proceeds of less developed countries and (*b*) assistance to less developed countries in the expansion of their

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commodity exports and their orderly adjustment to long-term trends in world demand for primary commodities.

(2) The United States and other industrial countries should avoid unilateral actions affecting the markets for primary commodities. These countries should also reduce tariffs and eliminate quotas on primary commodity exports and avoid domestic primary product programs which involve subsidies or other measures which depress imports of these products.

(3) Commodity agreements offer only limited promise for effective price stabilization in the short run, and their long-term effects may be harmful to the primary commodity producing countries. Although commodity agreements may dampen the price and volume fluctuations, the existing and prospective agreements attempt to maintain prices without regard for long-run trends in demand and supply relationships. If means can be found for mitigating the harmful effects of fluctuations through some form of insurance against sharp fluctuations in exchange earnings, then commodity agreements are not necessary as stabilization measures. As measures for influencing long-term trends in prices, commodity agreements are of doubtful value. Nevertheless the United States should not adopt a doctrinaire position on commodity agreements. If some form of exchange compensation arrangement is not put into operation, or if there are specific circumstances in which U.S. participation would contribute to an effective commodity stabilization agreement, such participation may be desirable. Each agreement should be considered on its own merits.

(4) In cooperation with all other nations the United States should seek to expand the availability of short-term credits to less developed countries which experience sharp decreases in export earnings. The International Monetary Fund should be encouraged to employ its resources for this purpose.

(5) Serious consideration should be given to the feasibility of an exchange insurance program which would make contingent loans to countries experiencing an export shortfall. Such loans should cover only a portion of the shortfall, in accordance with a predetermined relationship of the decline in export earnings to an average of total exports, say, in the previous 3 years. When exports recover, the loans would be repaid. Such a compensation scheme would permit less developed countries to maintain essential imports even when exports decline, thus facilitating orderly economic development.

(6) Study groups, councils, and conferences provide a means of reaching informal agreement on certain types of commodity problems, including the coordination of domestic production programs and export policies. The United States should participate actively in all of these efforts, especially those directed toward the improvement of the markets for the exports of less developed countries.

(7) The United States should consciously employ its agricultural surplus disposal program to promote and support economic development. Less emphasis should be placed on noncommercial exports as a means of reducing surplus stocks and more emphasis on the employment of our agricultural abundance for promoting economic development abroad. Since other countries are exporters of the same commodities included in our surplus commodity programs and are, therefore, vitally affected by U.S. noncommercial export programs, U.S. programs should be subject to international coordination and consulta-

tions designed to safeguard and promote the interests of both competing exporters and recipients of agricultural commodities.

F. EXTERNAL ECONOMIC AID TO DEVELOPING COUNTRIES

Various types of financial and technical assistance have been made available to developing countries, including stabilization assistance, loans, and grants for economic and social projects, surplus agricultural commodities, and the provision of professional and technical personnel for education, industrial and agricultural training, resource surveys, etc. Each type may have its place in the context of a long-range program in which there is a continuous relationship between the donors and the recipient countries, and a continuous review of the economic and social progress of the recipient countries. However, the several types of external assistance currently made available by various agencies should be integrated and directed toward the achievement of long-range economic, social, and political objectives for these countries. There has been far too much piecemeal and discontinuous assistance provided by a multitude of agencies without coordination at the country level and without any clear idea of what the overall impact of their activities may be.

Although there may be times when stabilization assistance in the form of external debt refinancing or general purpose loans may be necessary in order to assist a country in building a foundation of financial stability for sound development planning, this type of assistance should be used sparingly and with adequate safeguards. The most desirable type of development assistance is financial and technical help in the formulation and implementation of specific projects for economic and social development. Ordinarily such projects should be undertaken within the framework of long-range plans formulated by the developing country in consultation with, and perhaps with the help of, external assistance agencies. Although funds should ordinarily be allocated only as required for use in specific projects, there can and should be commitments of funds for financing a portion of a country's long-run development program over a period of several years, subject, of course, to the preparation of sound projects and the carrying out of agreed self-help measures. This approach to development assistance requires not only a continuous relationship and involvement in the development programs and policies of the recipient countries, but the closest coordination of the activities of various national and multilateral agencies operating in the country. Failure to establish a system of coordination of assistance activities at the country level constitutes perhaps the greatest weakness in our foreign-aid programs at the present time.

We have rejected any mechanical relationship between the volume of economic assistance and the rate of economic growth of developing countries. Foreign aid is basically a means of helping countries to help themselves, but in saying this we recognize that external agencies can have an important influence on the policies and programs of the host countries. In a sense, therefore, foreign aid, both financial and technical, should be regarded as a mechanism for influencing the policies of developing countries for achieving economic and social progress as well as a supplement to their resources.

Involvement by external agencies in development policies and programs which are concerned with monetary, fiscal, investment, and administrative policies of sovereign states is a delicate matter and the greatest care must be taken in order to avoid charges of political interference. This is one of the reasons why we have suggested that serious consideration be given to making available the bulk of our development assistance through regional and international institutions. For example, it is believed that the Inter-American Development Bank, or such agencies as the Economic and Social Council of the OAS and the U.N. Economic Commission for Latin America are in a better position to bring pressure on Latin American governments to adopt sound financial policies and social reforms than is the U.S. Government acting unilaterally. The creation of the International Development Association and the channeling of a large portion of our assistance to Latin America through the Inter-American Development Bank constitute significant moves toward multilateralizing our development assistance. However, we believe it would be desirable to move much further in this direction over the next few years, perhaps by channeling more of our aid dollars through IDA. This recommendation also reflects the view that as the relative economic position of the United States declines, we must exercise our leadership role more through multilateral organizations in which both the economic burden and the responsibility for achieving free world goals are shared, rather than through unilateral action.

In addition to these general conclusions, the following specific recommendations have been made in part II of this study:

(*a*) Surplus agricultural commodities should be more closely integrated with our long-range development programs. In this connection, the practice of "selling" agricultural commodities for local currencies should be abandoned in favor of commodity grants or sales for dollars on generous credit terms.

(*b*) The practice of making loans repayable in local currencies should be completely abandoned in both bilateral and multilateral programs. In most cases, aid should be made available on a loan basis with repayment and other terms geared to the recipient's capacity to service foreign indebtedness.

(*c*) Capacity to service foreign indebtedness should be determined jointly by all economic assistance agencies operating within a country so that a consistent policy may be followed. This does not mean, of course, that the county might not receive loans both from the World Bank under normal hard loan terms, and from AID or the soft loan window of the Inter-American Development Bank, under especially generous terms. However, coordination among the various lending agencies would assure that the "mix" of hard and soft loans would reflect an agreed position with respect to the country's capacity to service.

(*d*) Country-level coordination of all free world development assistance activities is essential to the basic approach outlined in the administration's new AID program. Such coordination should include: (1) An agreement on investment priorities in relation to medium- and long-term social and economic goals; (2) a coordinated review and common recommendations to local government officials with respect to individual country plans and programs; (3) coordination of long-term commitments of external funds called for by the

country's development plan; (4) coordination between the technical assistance agencies helping a country to formulate projects for external financing and the external financing institutions; (5) agreed positions with respect to the country's capacity to service so as to determine a proper overall relationship between hard loans, soft loans, and grants; and (6) agreed positions on recommendations to the country with respect to its internal monetary and financial policies.

(*e*) It is recommended that where a number of agencies are operating in a particular country and where development progress has not been assured, coordinating machinery to achieve the above objectives might be provided by a committee located in the country, on which all external agencies operating in that country were represented. The committee might be authorized to make specific joint recommendations directly to the headquarters of each of the agencies represented, as well as to a high level coordinating group in Washington. The functions of the country committees would be to review development programs and requests, or recommendations for, various types of assistance, and to reach agreed positions in connection with all negotiations with officials of the host country. Such negotiations might continue to be carried on by individual agencies or they might be conducted by representatives of the committee. Since each independent foreign assistance agency is autonomous in its own field, it presumably could not be forced to take an action or refrain from doing so, but the combined decision of a coordinating group operating in the country should carry considerable weight.

G. THE ROLE OF PRIVATE INVESTMENT

Throughout the postwar period, it has been a fundamental policy of the U.S. Government that direct private investment should play an important role in economic development abroad. In spite of various efforts to induce a larger outflow of private investment, its contribution to the poorer countries of the world, outside of the extractive industries and of a few of the more industrially advanced countries of Latin America, has been quite small. No magic formula is likely to be found for releasing a flood of private American capital to poor countries with limited markets and where great uncertainties prevail regarding governmental actions which may affect private enterprise. Nevertheless, we should bring private enterprise into partnership with public agencies in promoting economic development abroad. While recognizing that many fields are closed to private enterprise in developing countries, in many situations a private dollar combined with technical and managerial skills will contribute far more to development than several public dollars.

Both private enterprise interested in going abroad and public agencies concerned with promoting private foreign investment need to be aware of the attitudes of developing countries toward foreign investment and of the new patterns of relationship between the foreign investors and the host country. Developing countries want to select the kinds of foreign investments which are made in their economies and they want to make sure that the activities of foreign enterprises are consistent with their national objectives. In particular, they do not want to see vast petroleum or mining or plantation empires created within their boundaries under the control of for-

eigners; and they want to see the benefits from the technical and managerial skills embodied in foreign investment diffused through their economy. They are also very much concerned about the balance-of-payments impact of foreign investments. Developing countries tend to favor private investment in which there is a certain proportion of local capital participation. They also favor the maximum use of local supervisory and managerial personnel. In heavy industry and in fields such as petroleum and mining, as well as in public utilities, foreign countries regard enterprises as quasi-public in nature and, in many cases, private enterprise is welcome only on the basis of some form of joint control and participation by the host government. Finally, it is suggested that U.S. firms operating abroad might view their role more in terms of entrepreneurs seeking to mobilize domestic resources while using foreign capital and skills as catalysts, rather than as creators of large industrial empires over which they will maintain indefinite 100 percent ownership and control.

The administration's loan and all-risk guaranty programs for giving special encouragement to private investors in countries where certain investments are essential to the development program but where the investor is confronted with unusual risks, constitute a positive approach to the achievement of public-private partnership in realizing our foreign policy objectives. Special encouragement should be given to joint ventures either initially or after the investment is made. Where Government loans contribute a large portion of the capital of the private investment abroad, the U.S. Government should liquidate its own capital contribution to the venture by the sale of debentures convertible into equity shares to local interests in the host country.

A major weakness in the administration's program for promoting direct private investment in the less developed countries is its failure to emphasize tax inducements. In the light of the many studies and reports of congressional committees and of private and governmental groups favoring tax inducements, such measures should be given a fair trial. In this connection, certain specific recommendations regarding tax inducements, including the enactment of a foreign business corporation law, have been made in part III of this study.

PART II

EXTERNAL ECONOMIC AID TO DEVELOPING COUNTRIES

(By Raymond F. Mikesell)

The purpose of this chapter is to discuss the major problems arising out of the current programs and policies of the U.S. Government for promoting economic and social progress in the less developed areas, and to suggest some approaches to these problems.

Aside from humanitarian considerations, which have always played an important role in U.S. private and public relations with foreign countries, our foreign aid programs are primarily tools of American foreign policy designed to achieve certain objectives directly or indirectly related to the security and economic welfare of the United States. While the cold war with communism has certainly enhanced our concern for the economic and social problems and aspirations of the less developed countries, the United States would undoubtedly have a foreign aid program even if the Communist threat to our security were by some miracle to disappear. There are some who argue that by promoting prosperity in the poorer regions of the world we will be repaid severalfold by an increase in our own prosperity as a consequence of broadened trade opportunities. However, except for particular types of investment such as those directed toward expanding free world supplies of raw materials, this argument is at best unprovable. In most cases, funds made available in the form of low interest loans or grants would have contributed far more to the U.S. output if they had been invested in the United States. Moreover, for some types of foreign investments, their marginal contribution to total world output is probably less than the marginal contribution of the same investment expenditures made at home. Consequently our justification for development assistance abroad must be based mainly on the realization of important foreign policy and national security objectives, and perhaps more importantly on the promotion of world welfare goals suggested in part I of this study.

The relationship between foreign aid and the achievement of specific economic objectives in foreign countries is always tenuous since the realization of the economic objectives is only partly dependent upon external assistance. Yet tenuous as this relationship is, it is far more predictable and certainly easier to measure in retrospect than is the relationship between economic objectives and their political and social consequences. History has not provided us with a correlation between per capita output on the one hand, and political stability or democratic progress on the other. Some of the less developed countries with the highest per capita output have demonstrated the greatest instability. Nor have generous outpourings of external aid assured the continuance of pro-Western governments in power.

In both the short and the longer run, external aid may help a government and its people to deal with their internal conflicts and to maintain reasonable stability through democratic processes. But there is no guarantee that this will be the result. Moreover, the far-reaching revolutions which are going on in nearly all of the developing countries are likely to generate continuous social conflicts for many years to come, and will constitute a continual threat to internal political instability which could lead to dictatorships of the right or of the left.

At the present time in most of the countries of Latin America, Asia, and Africa, where we are directing our economic assistance, there exist middle-of-the-road governments maintaining a somewhat precarious balance of power between those forces which favor the traditional way of life and tend to oppose economic and social change on the one hand, and those forces that seek very rapid economic and social change through the establishment of authoritarian and dictatorial governments on the other. Politically the forces of the extreme left frequently have turned to the Communist world for inspiration and assistance to establish the social and economic system of their choice. By and large, however, the leftist leaders are not devoted to international communism as such, but are rather extreme nationalists in the sense that they look to an authoritarian state for the achievement of their social and economic goals and would deny any significant role to private enterprise. The coming to power of extreme nationalist groups is viewed as unfavorable to United States and free world security objectives because (*a*) such governments are likely to come under the influence of communism and become active allies of Russia in its struggle for world power; and (*b*) they may seek to undermine the independence of neighboring countries and thereby constitute a continual threat to world peace. The latter, of course, may also be true of governments of the extreme right. Basically then, the objective of the United States and its Western allies is to strengthen the position of those governments that are seeking to steer a middle course between the forces of reaction on the one hand, and the extreme left wing on the other. Fundamentally the realization of our foreign policy objectives depends upon the success of these middle-of-the-road governments in increasing their popular support by convincing the public that the best hope of realizing their social and economic desires lies in the maintenance of democratically constituted governments and of orderly processes of change and social reform.

The Kennedy administration's program for development assistance is apparently based in large measure on the approach outlined above. Most of the elements in the Kennedy administration's aid program were already present in one degree or another in that of the previous administration, but they have been made somewhat more explicit in the new AID program. These elements are (*a*) the emphasis on self-help and economic, social, and administrative reform measures by recipient governments as a condition for economic aid; (*b*) greater emphasis on social programs which are closely related to the desires of the people, while at the same time recognizing that continued social gains must be predicated on rising per capita output, and (*c*) the adoption of long-range programs for development assistance. The long-range approach to development assistance stems from the conviction: (1) That the realization of economic and political objectives for most less-

developed countries will require a decade or more, and (2) that the attempt to achieve short-term political goals through economic assistance is likely to prove disappointing. Indeed if aid for short-term objectives involves simply the temporary shoring up of shaky governments which are not responsive to the needs of the people, such assistance may in fact be harmful to our long-term objectives.

In the light of the foregoing analysis we shall examine briefly the various types of aid programs with respect to (*a*) the specific economic objectives to be served; (*b*) the actual forms of aid and conditions under which it is made available; (*c*) the institutions, both bilateral and multilateral, employed for administering development assistance, and (*d*) the economic impact of the aid burden on the United States and how it might be shared equitably with other developed countries.

A. SPECIFIC ECONOMIC PURPOSES SERVED BY THE AID PROGRAM

1. Stabilization assistance

During the postwar period a number of developing countries have experienced chronic inflation and balance-of-payments disequilibrium, necessitating the maintenance of severe trade and exchange controls or frequent devaluations, or a combination of both. Sometimes these conditions have been accompanied by the accumulation of large short- and medium-term external indebtedness to a point where the country's current external liabilities not only exceed its international reserves, but its current liabilities are in excess of the country's ability to meet them out of current foreign exchange earnings without drastically cutting essential imports. At this point the country must either obtain emergency external assistance or take measures of the most serious consequences for the growth and welfare of its economy.

These conditions are usually traceable to financial mismanagement and improper monetary policies. However, in some cases crises have been the result of unexpected decreases in foreign exchange income resulting from a sharp fall in export prices, or a substantial rise in import requirements as a consequence of a crop failure or natural disaster. Even in cases where a condition of chronic inflation and external disequilibrium has not resulted in a balance-of-payments crisis, a perpetuation of this condition makes rational development planning and economic and social progress extremely difficult. Private foreign investment is discouraged and external public lending institutions are reluctant to make long-term development loans. Thus for many countries the first step in a program for longrun economic and social progress is often a thorough financial reform which usually includes an exchange rate adjustment, the elimination of multiple exchange rates and import quotas and licensing, a balancing of the budget, restrictions on bank credit, the elimination of various types of subsidies, and other measures designed to end the cost-price spiral. Prices must be stabilized while at the same time price disparities which result in a misdirection of production and investment must be eliminated.

In the first instance countries in this condition should seek stabilization assistance and technical advice from the International Monetary Fund, but frequently a country's quota in the Fund is too small to deal with the problem. In addition, a country in this position usually needs longer term assistance than that normally provided by the Fund.

The function of the IMF is to provide relatively short-term assistance to take care of temporary deficits in the balance of payments. But countries often need longer term assistance to enable them, in effect, to fund their short-term commercial obligations and to maintain a volume of essential imports for both current consumption and investment until the new financial reform measures have had time to effect a balance in their current account (aside from imports financed by long-term development credits or by grants).

U.S. experience with stabilization or balance-of-payments assistance to less developed countries has not been altogether satisfactory. In several instances, particularly in Latin America, the Export-Import Bank has made emergency loans principally to bail out United States and other foreign creditors that have extended excessive short- and medium-term export credits to these countries. While promises of financial reforms were made, financial mismanagement continued and in a few years the countries receiving the emergency credits were in the same or frequently in a worse condition than before. Between 1955 and the middle of 1961 the Export-Import Bank alone has made available in loans (or refinancing of old ones) well over a billion dollars in the form of general purpose or balance-of-payments assistance, most of it going to a few Latin American countries. Where such assistance has not been accompanied by genuine stabilization programs, it has not promoted sound development but rather enabled the receiving country to continue to live beyond its means and get further into debt.

On the other hand, recent experience with several stabilization loans has been generally satisfactory and has undoubtedly provided a foundation for successful development planning and growth. For example, when the Frondizi government came into power in 1958, the cost of living in Argentina was rising at an annual rate of over 100 percent and foreign exchange reserves were melting away fast as a consequence of stagnating exports and rising imports. In December 1958 Argentina signed an agreement with the IMF providing for a number of financial reforms. These reforms included the termination of deficit financing through the central bank, a limitation on the amount of central bank credit available to the commercial banks, and the substitution of a free unitary exchange rate in place of multiple exchange rates and a complex of import restrictions. To assist this process of stabilization, a package aid program totaling $329 million was provided by the IMF, the Export-Import Bank, the U.S. exchange stabilization fund, and a group of private banks. Subsequently additional amounts were provided by external agencies. In accordance with the 1958 agreement, the Argentine Government undertook a substantial reduction of federal expenditures and succeeded in limiting wage rises in the face of a continued rise in the cost of living resulting from the removal of subsidies and the devaluation of the peso. In spite of substantial opposition, including strikes in various industries and the political unpopularity of the Government's economy measure, the Argentine Government stood firm and the stabilization program appears to have paid off. The external value of the peso has held steady for almost 2 years; the cost of living rose by only 6 percent during the year ended March 1961; and between the end of 1958 and the first quarter of 1961 Argentina's official gold and exchange reserves rose by some $560 million. In addition, the value of

Argentine exports rose by $100 million, or by some 10 percent, between 1958 and 1960, while imports declined in spite of the increase in domestic investment.

A similar stabilization assistance program was undertaken in Chile following the election of President Allessandri in November 1958. Again as a consequence of an agreement with the IMF, a free unitary rate was established, budgetary expenditures were drastically limited, credit curtailed, price controls eliminated along with a freeing of many imports from quota and licensing controls, and wages held down. After more than a generation of high and continuous inflation, reasonable stability was at last achieved, and in 1960 the cost of living rose by only 5.4 percent. In 1959 similar stabilization programs were also undertaken by Peru and Uruguay with assistance from the IMF and the U.S. Government. In both cases the countries have lived up to their agreements with the IMF, and in both countries the stabilization programs have succeeded in halting the inflation and improving the balance of payments.

When Janio Quadros became President of Brazil early in 1961, he inherited a financial condition similar in many respects to that found by President Frondizi in 1958. Not only had the cost of living been rising at rates of 30 to 50 percent per year, but Brazil had accumulated a very heavy burden of short-term indebtedness. As in the case of Argentina, Brazil's inflation was generated in very large measure by substantial governmental deficits financed through the central bank. Following negotiations with the IMF, Brazil obtained financial assistance from the U.S. Government, international institutions, and other sources totaling well over a billion dollars, most of which will be employed to repay or reschedule past debts rather than for increasing imports for promoting development. Thus the Export-Import Bank rescheduled payments amounting to over $300 million owed to the Bank by Brazil and provided $168 million in new funds. The U.S. exchange stabilization fund agreed to provide up to $70 million, the IMF agreed to a standby credit of $160 million and arranged for a rescheduling of payments totaling $140 million owed to the fund under previous drawings. Another $100 million is to be made available to Brazil by the U.S. Government under the new AID program. Finally, Brazil was able to renegotiate some $300 million in medium-term indebtedness owed to European creditors. Under the arrangement with the IMF, which was tied to the package assistance from the U.S. Government, Brazil agreed to a number of financial reforms necessary for the internal and external stability of her currency.

Evaluation of stabilization assistance.—Stabilization assistance in the form of balance of payments or general purpose loans, most of which go directly or indirectly for refinancing old indebtedness, is one of the most speculative and controversial forms of assistance to developing countries. One approach might be to tell countries to renegotiate their indebtedness to various foreign private and governmental creditors and put their financial houses in order without any special assistance from the United States. In some cases this would serve to make exporters less willing to extend short- and medium-term credits to developing countries. This might be highly salutary in helping the countries keep out of financial difficulties. Moreover, there is always the danger that solemn agreements to undertake financial reforms will be repudiated by the government negotiating

them or by succeeding governments, because of their political unpopularity. It could be argued, therefore, that a country must learn the lessons of financial discipline the hard way and not to expect to be bailed out by the U.S. Government following a period of financial mismanagement. Under this policy the United States would simply announce that except for stabilization assistance from the IMF, it is interested only in providing funds to finance imports for development projects and not for assisting countries with balance-of-payments problems of their own making.

While recognizing the dangers involved in stabilization assistance of this type, it would not seem desirable to take a doctrinaire position on this issue. We must recognize that in Latin America as well as elsewhere we are by and large dealing with middle-of-the-road governments, most of which are currently dedicated to sound principles of finance and development policy. Responsible fiscal and monetary management constitutes a relatively new conviction in a number of countries such as Argentina, Chile, and Brazil, where for many years inflation has become a way of life. Halting an inflation inevitably means taking measures which may for a time affect adversely the relative economic welfare of certain groups, while improving the lot of others. For example, stemming the rise in wages and reducing swollen government payrolls, either by pay cuts or discharging workers, alienates industrial workers and an important section of the middle class. At the same time that wages are curtailed, the cost of living inevitably continues to rise for a time, as price controls are lifted, subsidies removed, and exchange rates and import prices allowed to find equilibrium levels. Although the farmers may be benefited from these measures, the benefits of increased prices of agricultural commodities may not be immediately passed on to tenants or farm laborers. Thus leftwing groups make a great deal of political capital over the dissatisfaction engendered by stabilization programs. The burden of the stabilization measures must be tempered by maintaining imports, and popular dissatisfaction must be overcome by soundly based social reforms which will improve the lot of both the urban worker and the peasant. Otherwise, in the next elections, leftwing extremists may overthrow progressive, middle-of-the-road governments. Thus it is important that stabilization measures be accompanied by social reforms which not only offset hardships felt by the lower income groups, but also give them the feeling that the United States and the Western Powers, which largely determine the policies of the IMF, are not simply concerned with "orthodox" finance for the benefit of the rich. Of major importance in this connection is a change in the tax system in favor of a progressive income tax and higher taxes on large landholdings. It might be well, for example, for the IMF to include financial reforms of this type in its agreements with countries in need of stabilization assistance.

Before leaving the topic of stabilization assistance, special mention should be made of the use of an international agency such as the IMF in the negotiation of agreements with the recipient countries for financial and economic reforms which constitute, in effect, the conditions under which the larger amounts of aid from the U.S. Government and other sources, private and governmental, are made available. In this particular field the IMF has special responsibilities stemming from the provisions of its articles of agreement which state the conditions

under which fund assistance shall be made available. Bilateral discussions relating to a country's budget, exchange rate, or central bank policies are more difficult for the United States in setting forth aid conditions. Many of the conditions for self-help which we may want to include in our agreements relating to the provision of development assistance are equally delicate, and it may often be easier for the United States to tie its aid to agreements arrived at by international agencies, such as the World Bank, or regional agencies, such as the Inter-American Development Bank (IDB) or the Organization of American States (OAS). Such arrangements will at least help to avoid the charge of direct interference by the United States in the internal economic and political affairs of recipient countries. We shall return to this question at a later point in this discussion.

2. Assistance for long-range economic development

The distinction between long-range economic development and social development programs is by no means clear either from the standpoint of the fundamental purposes to be served, or of the forms in which the assistance is to be made available. However, long-range economic development is usually identified with investment projects in industry, agriculture, mining (including petroleum), and basic services and facilities necessary for industrial and agricultural output, such as power and transportation. Social projects, on the other hand, relate more to the immediate improvement of the welfare of the lower income classes, or, as in the case of education, involve a combination of social welfare and a longrun investment for increasing future output and productivity. Certain projects in agriculture, such as irrigation and mechanized equipment for commercial farming, are regarded as long-range economic development, while other projects, which may also contribute to agricultural output, are associated with land reform or rural improvement and, hence, fall in the social reform category.

Long-range development assistance has tended to absorb the largest proportion of the external public economic assistance to developing countries. Most of this assistance in the past has been provided for specific projects, and the assistance has taken the form of financing from institutions such as the Export-Import Bank, the World Bank, the DLF, and ICA for the purchase of the imported components of hydroelectric dams, highway or railroad construction, or industrial plants, in the developing countries. By and large the local currency expenditures have been met from internal private or governmental sources. Moreover, as in the case of stabilization assistance, most of the long-run development assistance has been made available to governments or to quasi-public institutions. This is partly because most of the large projects are in the public sector of the economies and partly because much of the assistance to private industry or agriculture is channeled through government agencies. For example, governments may borrow abroad for the financing of capital equipment for industry or for agricultural implements to the rural sector which government agencies sell directly or through dealers to private firms or cooperatives. Alternatively, the loans may be made to the governments or to government development banks, which then make available the foreign exchange proceeds to other private or governmental

organizations for the purchase of the equipment or other imported commodities associated with the projects to be financed by the loans. External lending agencies are ordinarily not in a position to make a large number of small loans because of the administrative costs and also because they do not have resident offices in the developing countries.

One of the criticisms of our development lending in the past is that a disproportionate share of the external financing has gone to government projects and to large concerns that are able to borrow directly abroad or have close connections with governments. Small- and medium-sized industrial firms and farms are thus often starved for capital or must pay enormous rates of interest, while Government agencies and a few large firms obtain capital on terms even more favorable than private borrowers in industrial countries. In order to deal with this problem, international lending agencies have been promoting the creation of, and making loans to, national development banks which in turn reloan to medium and small enterprise in the developing country. Greater attention needs to be paid to the use of local development banks for channeling more capital into the private sector of the economies of developing countries, but as will be pointed out below, administrative and other difficulties have prevented a wider use of this technique.

Since the purpose of long-range development assistance is to promote a balanced growth of the economy for meeting both internal demands and for expanding the export sector so as to enable a country eventually to meet its import requirements from foreign exchange earnings, the financing of individual projects should not be considered apart from long-range development plans which provide a system of investment priorities and a picture of the interrelationship between the growth of various sectors of the economy. Also for most developing countries, there is a need for technical assistance in combination with financial assistance in promoting long-range development goals. In the past a principal shortcoming of our development assistance, at least for most countries, has been the failure to coordinate the financing of individual projects and various technical assistance programs in relation to the long-range development requirements of the country. Projects have been regarded more or less in isolation and as ends in themselves by the individual agencies undertaking their financing.

Growth targets and foreign aid.—Long-range development assistance constitutes an important element in any program for raising per capita output in developing countries. Most developing countries have stated their economic goals in terms of increasing their per capita output by a certain percentage—say, 2 percent per annum—over a period of years, and they have tended to regard the amount of external capital assistance as perhaps the most important factor in determining their ability to achieve these growth targets. Thus, if a country is currently investing 6 percent of its national income in productive facilities and its capital-output ratio is estimated at 3-to-1,[1] total output will rise by about 2 percent per year. If population is increasing at a rate of 2 percent per annum, output per capital would

[1] A 3-to-1 capital-output ratio means that for every $3 worth of investment in a country, there will result an increase of $1 in its annual output.

remain stationary. However, if an amount of external capita equal to, say, 3 percent of the country's national output is provided for investment purposes, total annual investment rises to 9 percent, output per annum increases to 3 percent, and per capita output would increase by 1 percent per annum.

However, such a mechanical relationship between external aid and investment, on the one hand, and economic growth, on the other, constitutes a greatly oversimplified picture of the development process and cannot be used as the basis for determining the amount of economic assistance required to achieve a certain rate of economic growth. Economic growth is a product of many factors of which the availability of capital is but one. Foreign financial and technical aid can assist the growth process, but it cannot guarantee a particular rate of economic growth. Even the amount of development assistance that can be absorbed or productively used by a country is dependent upon a large number of internal social, political, and economic factors which together help to determine the rate of economic growth. To the extent that long-term development assistance can be productively employed, its fundamental purpose should be to assist a country in achieving what has come to be called a condition of self-sustaining growth, i.e., one in which domestic savings, technical and managerial skills, and entrepreneurial activity have reached a level which will enable the country to maintain a continuous increase in output per capita without further external public assistance. A discussion of the amount of financial and other types of assistance required for self-sustaining growth is reserved for a later section.

3. Assistance for social development

Emphasis on United States and multilateral assistance for social development in U.S. aid programs is of rather recent origin. There have, of course, been a number of technical assistance programs for improving health and education, and limited sums have been spent on rural improvement, including measures for increasing the productivity of small farms and for rural community development. However, the development financing agencies, such as the World Bank and the Export-Import Bank, and even the Development Loan Fund (at least before 1960), have by and large stayed away from financing so-called social development projects as contrasted with productive projects. There are several reasons for this, some of which might perhaps be justified in terms of investment priorities, if one is concerned solely with the increase in the gross national product of a country as it is usually measured. Social projects such as slum clearance, housing, schools, hospitals, and rural improvement are often difficult to evaluate from a purely economic point of view. Also, in many cases they require legislation in the host country, changes in administrative procedures, and a considerable amount of technical assistance.

The first important evidence of a change in emphasis in favor of assistance for social development came with the Act of Bogotá.[2] At the Bogotá Conference in September 1960, the U.S. Government on the basis of an authorization by the Congress of August 31, 1960, pledged to the establishment of a special Inter-American Fund for Social Development totaling $500 million, subject to congressional

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[2] For the text of the Act of Bogotá and an analysis of the Bogotá Conference of September 1960, see "Report of Senators Wayne Morse and Bourke B. Hickenlooper to the Committee on Foreign Relations," U.S. Senate, Feb. 27, 1961, 87th Cong., 1st sess.

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appropriation. This Fund, money for which was subsequently appropriated, is to be used for social projects in Latin America of the following general types: (*a*) Improved land use and rural living conditions; (*b*) housing for low-income groups; (*c*) water supply and sanitation; (*d*) education and training; (*e*) public health facilities; and (*f*) measures for the mobilization of domestic resources, including assistance for maximizing domestic savings and tax reform. Development assistance for similar types of social programs is provided for under the administration's new AID program for all developing countries with special emphasis on Africa.[3]

The determination of the administration to provide a larger role for social development in its foreign assistance programs is a consequence of a perhaps belated realization that unless social progress goes hand in hand with overall economic growth, the political objectives of our economic programs will not be realized. If, for example, industrial output continues to expand in the industrial centers of Latin America and agricultural productivity is increased on the large farms and plantations, but at the same time the ring of slums surrounding the industrial centers continues to grow and the lot of the Andean or northeastern Brazilian peasant does not improve, or even declines, the political battle will be lost. A similar problem exists in many Asian countries, while in Africa the problem of the changeover from a tribal to a modern agricultural and industrial society involves such complex social problems that a great deal of experimentation and research will be necessary in some areas just to determine where our maximum effort should be placed.

In the past there has been some tendency to regard social projects and social reforms as internal matters and largely outside the realm of external assistance except where a specific technical assistance job was needed and requested. Moreover, many of the social projects can be financed very largely by local expenditures with little direct foreign exchange outlays. Mainly what is required is a basic change in internal governmental legislation and fiscal administration.

While it might well be argued that a lack of foreign exchange or external assistance has not been the fundamental barrier to the adoption of social programs, the offer of external assistance for formulating and providing initial assistance for such programs as land reform, slum clearance, improved education, etc., may serve as a prime mover or catalyst for social progress; once projects and programs are initiated, they are very likely to be continued and expanded by the local governments.

Although programs for social development are exceedingly important from the standpoint of their political impact, they cannot be carried on and expanded by local governments in the absence of a sound production base and growing national product. Many of these programs, such as education, health, and even land reform programs of the proper type, will in the long run increase productivity, but they also involve an increase in social consumption which represents a drain on the national product. There is always a difficult problem of judgment as to how far countries should go in improving housing, education, and even health services in relation to the level and rate of growth of their total output. Decisions in this field require the

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[3] See "An Act for International Development, a Summary Presentation," June 1961, pp. 56 ff.

closest collaboration among the various agencies, bilateral and multilateral, which are engaged in providing assistance for social development.

It must also be emphasized that social programs need to be accompanied by a substantial amount of technical assistance and supervision—much more than in the case of economic projects, such as highways and railroads. This technical assistance and supervision must either be provided directly by the agency responsible for financing the project or in closest collaboration with other technical assistance agencies. Since collaboration between two agencies is often difficult to achieve, a combination of technical and financial assistance from the same agency may be more effective administratively.

Agencies such as the Export-Import Bank and the Development Loan Fund have taken pride in the fact that they are able to lend hundreds of millions of dollars each year with a very small professional staff and with administrative expenses of only a fraction of 1 percent of total loans. For example, the Export-Import Bank has a budget for personal services totaling less than $2 million a year, while lending $700 or $800 million annually. We do not regard this as desirable since it is impossible for such a small staff adequately to investigate, supervise, and provide continuous review for several hundred loans each year aggregating such large sums of money.[4] The Congress should not be impressed by a low ratio of operating expenditures to total development loans. Agencies should not be interested in seeing how much money they can lend, but rather in how effectively the funds can be used and how successful they can be in influencing the development policies of the recipient countries. This point has special application for assistance in the field of social development.

4. Supporting assistance and emergency aid

The administration's new AID program provides for "supporting assistance" designed "primarily to promote urgent U.S. national security and foreign policy objectives in selected countries." By and large this request for assistance is designed for the same countries and to serve much the same purposes as "defense support" under earlier programs. Some of this assistance in the past has gone into development projects, but by and large it has taken the form of support for meeting foreign exchange and budgetary deficits of recipient countries. Although such assistance is closely related to our military programs and objectives in the recipient countries, it is not possible to separate budgetary and foreign exchange deficits incurred as a result of a given level of military effort from those due to other factors. Nevertheless, it would certainly be desirable to separate the purely defense support aspects of our aid programs from those aspects which are related to long-run development on the one hand, and a subsidy to the country's consumption level on the other. The administration's "Summary Presentation" of the AID program recognizes this problem and indicates that "increased emphasis will be placed on working with these countries to achieve economic growth. As their levels of economic activity rise, they should be able increasingly to

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[4] The Export-Import Bank's total budget for personal services for the year ended June 30, 1960, was only $1.7 million and its total professional staff numbered less than 250. Its total staff is less than half that of the World Bank, although World Bank makes a smaller number of loans and the total value of its loans is usually smaller.

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finance the local costs of their defense budget out of domestic revenues plus the local currency proceeds of our agricultural surplus programs." [5]

In addition to supporting assistance related to our military objectives in certain countries, there will always be crises such as the political eruption in the Congo, earthquakes in Chile, and floods in the Philippines, which will require, for both humanitarian and foreign policy reasons, U.S. assistance. Ample resources should be available in the President's contingency fund for dealing with emergencies of this kind. However, apart from immediate relief needs, assistance from the contingency fund should be made available for well-conceived programs which fit the development plans and potentialities of the recipient country.

B. TYPES AND CONDITIONS OF FOREIGN AID

1. Specific project versus general purpose loans or grants

A major issue in the field of development assistance has been that between financial assistance specifically designed for individual projects, and general purpose loans for financing a broad range of commodities for use in a number of investment projects either in a particular sector of the economy or for development projects generally. For example, a loan might be made to cover the direct foreign exchange costs involved in building a particular steel mill or a section of a highway; or a development loan may be made to finance highway development in general. Alternatively, a country may obtain a loan to finance imports of capital goods for a wide variety of investment projects set forth only in the most general terms in the loan agreement. From an examination of hundreds of loans made by our public lending agencies, the distinction between specific project loans and general purpose development loans is often unclear and many loans seem to fall someplace in between the two concepts. Moreover, a "project" itself is not well defined; it may be anything from a few locomotives or a dozen tractors for a tractor pool, to a gigantic hydroelectric dam and irrigation system.

What is fundamentally significant in this whole field is the relationship of the lending (or granting) authority to the overall development programs and policies of the recipient country. It is much more important for our development assistance agencies to influence, and maintain a continuous review of, the development plans and economic and social progress of a country, sector by sector, than it is to make sure that a certain proportion of funds allocated for a particular section of a highway is spent for bulldozers or shovels which meet agreed specifications.

Project type loans are frequently favored because it is said that only in this way can we be sure that external funds are used for productive projects. But of course what is really important is how a country allocates its total investment expenditures, whether derived from internal or external sources. On the other hand, the project approach to development assistance does have a very definite advantage in that it provides the lending or granting authority an opportunity to review in detail proposed projects in relation to alternative uses of capital and for its officials to involve themselves more deeply in the development

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[5] Ibid., p. 84.

plans for particular sectors of the economy. It is for this reason that we tend to favor the project approach to development assistance, not so much with the idea of making sure of what is happening to every dollar made available, but rather as an administrative mechanism for achieving a greater degree of involvement in the development process of a country. Although individual projects should not be considered in isolation and out of context with the general pattern of a country's development, it is not enough in most cases simply to make large general purpose development loans on the basis of a broad development plan, no matter how well conceived. A review of the engineering, accounting, and economic aspects accompanying an application for a specific project loan will often have an educational value for the officials of the developing country, which will carry over to projects financed by the country out of its own resources. Also, any close examination of an individual project requires a detailed examination of related projects which are to be financed from other sources, and more broadly, a review of plans for the entire economic sector into which the project fits as well as the relationship of that sector and its projects to other sectors of the economy.

In the past the tendency on the part of development assistance institutions to concentrate on projects rather than on long-range development programs has been criticized because it is impossible for countries to undertake long-range planning unless they know where the financing of individual projects is going to come from over a period of time. Thus it is argued that individual development institutions or a consortium of institutions should make large general purpose development loans to assure the availability of funds over a period of several years. This is a valid consideration, but a commitment to provide financing up to a certain level for a long-range development program is not inconsistent with the project approach. The development assistance agency can agree in advance to make available a certain amount of aid over a period of years by agreeing to financing individual projects as they are formulated by the country and reviewed by the assistance agency. In addition, the development agency should be in a position to offer technical assistance in the formulation of projects suitable for external financing so as to provide a continuous flow of development assistance in accordance with agreed long-range plans and commitments of funds. The implementation of this approach, of course, requires considerable flexibility with respect to the timing of the actual allocation of funds and therefore argues for the availability of funds over a period of years rather than dependence upon annual appropriations. Dependence of development assistance agencies on annual appropriations not only makes it difficult for them to promote rational development planning by a long-range commitment of funds, but in addition, it puts aid agencies under pressure to make allocations of funds before the end of a given fiscal year. This not only may mean waste as a consequence of misdirection of investment, but also weakens the position of the development assistance agency in influencing the policies and programs of the recipient countries.

2. Surplus agricultural commodities

Sales of surplus agricultural commodities under title I of Public Law 480 and grants under titles II and III have been employed for

a combination of purposes, some of which have not always been compatible. Strong support for these programs has come from agricultural interests who see them as means of getting rid of agricultural surpluses so that the U.S. Government can pursue a domestic agricultural program designed to generate a continuous flow of surpluses. This primary interest has been combined with a genuine desire to see our artificially created surpluses employed to feed the hungry peoples of the world. Of course, if we want to maintain a farm program which will generate an indefinite flow of certain agricultural commodities which can be used to subsidize, directly or indirectly, the level of living of millions of people in the low-income countries of the world and can do it in a way which will not jeopardize the markets of producers in other countries, there can be no objection to such a course on foreign policy grounds. It might be said, however, that if we want to help poor people by subsidizing their incomes, we might be able to make a more significant contribution to their welfare by employing the same human and material resources that are used to produce the surplus agricultural commodities for the production and delivery of other commodities. In other words, man does not live by wheat and cotton alone.

However, in this paper we are interested in economic development. We are not concerned with the wisdom of our farm policy which generates these farm surpluses nor with the desirability of providing an indefinite subsidy to the level of living of poor people. Therefore, it is important to determine how these commodities can be employed to promote a higher level of productive investment, and hence an expansion of output, in less-developed countries, rather than simply provide a temporary supplement to their consumption. Most students would agree that from the standpoint of both the economic welfare of developing countries and the realization of our long-run political objectives, an expansion of their productive capacities and level of output is far more important than a somewhat uncertain supplement to the level of consumption of a small portion of the billion or so people in the poorer areas of the free world.

The effective use of imported foods or fibers for increasing the level of investment and production in developing countries presents complicated problems which differ greatly from country to country. Contrary to popular opinion, it is not ordinarily possible to put people to work building highways, dams, or steelmills simply by issuing them rations in terms of so many bushels of wheat. Not only do people need to work with tools and raw materials, but they need wages with which to buy processed foods and suitable clothing, transportation, housing, and a few amenities appropriate to their new environment. Shifting surplus or underemployed labor off of farms to productive work in investment projects involves much more than providing them with some additional wheat or flour. On the other hand, food as well as other surplus agricultural commodities employed in combination with financial and technical assistance for implementing a well-conceived development program is entirely feasible. But in any given situation there are limits to the absorptive capacity for food imports as a contribution to development, just as there are limits to the absorptive capacity for steel or machine tools or plows. Thus without going into the many ramifications of this problem, the important point is that agricultural commodities, if they are to be

used for development, must be closely coordinated with other forms of aid, and their availability over a reasonably long period of time must not only be assured, but they must be taken into account in a country's development program. Thus the availability of so many million bushels of wheat for a developing country over a 5-year period should make an important difference in the way its investment funds are to be allocated.[6]

3. Aid terms: Grants and loans—hard, medium, and soft

The terms on which development assistance is made available may be determined on the basis of either the type of assistance provided or on the basis of the capacity of the recipient country to service foreign obligations. The terms on which U.S. and multilateral development assistance has been made available to various countries constitutes a hopeless hodgepodge which, by and large, defies any rational explanation. Some countries are receiving hard loans (repayable in dollars at 5¾ percent from the Export-Import Bank or the World Bank), loans repayable in local currencies from the DLF, agricultural commodities in exchange for local currencies under Public Law 480, and, in addition, loans from the private capital markets of the world. The International Development Association has recently made several loans repayable over a 50-year period in foreign exchange, but without interest. The loans to be made by the new Agency for International Development (AID) are to be repayable in dollars, but on much more generous terms than loans from the Export-Import Bank, the World Bank, or the hard-loan window of the Inter-American Development Bank. Some countries receiving hard loans are also recipients of grants for certain purposes. In some cases there are perhaps administrative reasons for providing grants rather than loans. For example, certain types of technical assistance projects in which the personnel is provided directly by the U.S. Government or an international agency might involve special problems if undertaken on the basis of a loan agreement. On the other hand, technical assistance in the form of contracts with private groups in which the recipient country has some voice in the selection of the private agencies might well be financed on a loan basis.

Except where the nature of the technical assistance creates special problems for loan financing, it seems desirable to base the terms of financing of development assistance on a judgment regarding a country's capacity to service foreign obligations. Moreover, there are strong reasons for preferring loans—however generous the terms—over grants in nearly all cases. Also there appears little justification for differentiating between grants and loans on the basis of whether the project constitutes economic development or social development. It might be argued, of course, that some developing countries would refuse to enter into loan contracts for social development programs or that they would be less willing to undertake basic self-help or reform measures if the assistance were to be made available in the form of a loan rather than as a grant. In addition, there may be cases where grants would be appropriate for nonprofit private organizations abroad such as American schools or hospitals. All of these factors need to be considered. However, in the case of govern-

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[6] For a discussion of some of these problems, see "Development Through Food: A Strategy for Surplus Utilization," United Nations Food and Agricultural Organization, Rome, May 1961.

mental projects which must eventually be financed and expanded from public revenues, a distinction between grants and loans based on whether the investment adds to the "social" capital or "economic" capital of a country does not appear to be a very sound one, since quite obviously a country requires different types of capital, all of which contribute to the expansion of the social value product.

The attempt to deal with the grant-versus-loan problem by requiring countries to pay in local currencies has been recognized by the administration as an unfortunate experiment which ought to be liquidated as soon as possible. The administration's new AID program wisely provides that development loans—

> will be repayable in dollars, will bear interest at low rates, or will be interest free, and will extend for terms up to 50 years, with substantial grace periods where warranted.

In justifying this position, the "Summary Presentation" states that—

> the shift to dollars from local currency repayment is being made because experience has shown that substantial, unusable local currency accumulations constitute a source of misunderstanding and friction between providing and receiving countries and do not make economic resources available either to the United States or the receiving country. Moreover, aid-receiving countries are likely to husband their dollar resources more carefully if they are obligated to repay loans in dollars. In addition, the United States is entitled to be repaid in dollars if receiving countries achieve sufficient growth so that they are able to make such repayments.[7]

The International Development Association (IDA) has rejected the local currency repayment approach in favor of repayment in dollars on generous terms. However, the soft-loan window of the Inter-American Development Bank and the Social Progress Trust Fund administered by the IDB under a trust agreement continue to make loans on a local currency repayment basis. Also, under title I of Public Law 480, sales of agricultural commodities continue to be made for local currencies with the result that in some countries the United States is accumulating enormous quantities of local currencies that it will never be able to use for its own purposes and will constitute a source of misunderstanding and administrative difficulties for many years to come. It would be highly desirable to put the whole title I, Public Law 480, program on a basis similar to that provided by title IV of Public Law 480 as amended in 1961. This would involve the sale of the agricultural commodities on very generous credit terms, but with provision made in the credit agreement for appropriate controls on the use of the commodities in relation to the country's development program. The credit terms could be related to the country's overall capacity to service foreign indebtedness.

There is, of course, no harm in the same country's receiving development assistance from different sources under varying credit terms, provided that the "mix" of hard and generous repayment terms is determined in relation to the country's capacity to repay. But this could only be done by the closest coordination between the activities of, say, hard-loan institutions such as the Export-Import Bank and the World Bank, and soft-loan development agencies such as IDA and AID.

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[7] See "An Act for International Development, Fiscal Year 1962, a Summary Presentation," US GPO, June 19, 1961, p. 34.

4. Conditions attached to assistance: Self-help, development planning, and economic and social reforms

The emphasis given to self-help measures in the President's foreign aid message of March 22, 1961, and in his alliance for progress address of March 13, 1961, stems from a recognition of two fundamental factors: (*a*) External economic assistance is mainly a means of helping people to help themselves, and the basic responsibility for achieving national economic and social welfare goals must lie with the developing countries themselves; and (*b*) basic economic reforms in the fields of taxation, land tenure, governmental administration, and social and economic justice generally are not only essential conditions for overall economic progress in many developing countries, but are indispensable for the realization of our political and social objectives.

In the past far too many of our aid dollars have been used in a haphazard way to provide temporary support to weak, corrupt, and unresponsive governments. While virtually all governments of poor countries regard economic development and social progress as a fundamental goal, many, if not most, have failed to formulate comprehensive programs and to take measures which mobilize fully the resources of their economies for the achievement of this goal. The political leaders of these countries exhort the United States and international institutions to provide more economic assistance, but they have not taken the steps which would make it possible for them to use economic assistance effectively and productively. Of course, they would all like large amounts of untied dollars or other foreign exchange for meeting balance-of-payments deficits, but aid provided in this way may either not promote economic growth or it may serve to prolong a condition under which some sections of the country or economic groups enjoy rapid economic growth and prosperity while others continue to stagnate.

Anyone who has traveled in Latin America is conscious of the dualistic nature of the Latin American economies. For example, in Venezuela, which has a per capita GNP of $600–$700 per annum (approaching that of some of the countries of Western Europe), only about 10 percent of the population (including the petroleum workers) enjoy relatively high levels of living, while the remaining 90 percent are little, if any, better off than the rural populations of most other Latin American countries which may have per capita incomes of $100–$200 per year. Nearly 50 percent of the population of Venezuela is illiterate, and most of the labor force in the rural areas is composed of landless workers or subsistence farmers. A similar picture of economic dualism exists in Brazil and Peru.

In the presentation of the administration's new AID program special emphasis was given to the need for development planning as against the financing of isolated projects which are not formulated within the framework of a broad economic program, and with only sporadic or discontinuous relationships between the various external economic assistance agencies and the individual developing countries. It must be recognized, however, that a development plan, no matter how well conceived, does not constitute a magic key or formula to successful growth. Most developing countries of the world have something which they call a development plan, but in most cases they are not based on an adequate survey of resources, on longrun projections of demand for commodities and services, on a properly

balanced and consistent set of output and investment requirements, and on a realistic appraisal of the requirements for increased exports and how to achieve them. At best development plans are guidelines which must be modified continuously in the light of changing circumstances. Moreover, they do not provide a basis for economic assistance until plans are translated into carefully formulated projects for the various sectors of the economy, either by public agencies in the case of the public sector, or by private firms in the private sector. Development planning and its implementation are an integral part of the day-to-day operations of governments at various levels and of private enterprise within a country.

The administration's "Summary Presentation" of the AID program does not take a doctrinaire attitude toward planning and planning techniques. At present only a few developing countries have reasonably adequate development plans or, in fact, are capable of formulating them within the near future. In most of the new countries in Africa, for example, basic resource studies have not been undertaken, while in many of the countries of Latin America and Asia adequate surveys of such important sectors of the economy as power and transportation and the need for these services over the next decade have not been made. Thus before reasonably adequate development plans can be formulated, a substantial amount of so-called preinvestment projects must be undertaken, such as, for example, the transportation study in Argentina which is being financed by the United Nations Special Fund under the direction of the World Bank.

At the other end of the spectrum there are a few developing countries such as Mexico, where development is progressing satisfactorily and where formal 3- or 5-year overall plans which employ elaborate statistical techniques may not be appropriate. This does not mean that planning for certain sectors of the economy is not necessary in all countries, even in the United States, but there are countries where government and private firms and financing agencies have achieved a relatively high degree of sophistication in determining investment priorities on the basis of the operation of the price system and free market forces. For such countries formal overall planning of the type represented by the Indian 5-year plans are not only unnecessary for successful growth, but might introduce elements of inflexibility into the system which would actually inhibit growth.

It should be made clear that development planning is in no sense antithetical to the free enterprise system. In most developing countries, the government plays a somewhat larger role, particularly in the fields of transportation and public utilities and often in heavy industry, than in developed countries. On the other hand, the publication of a development plan which indicates the expected pattern of growth and the requirements to be supplied by industries in various sectors of the economy over a period of years, should provide a valuable guideline to private investors and also to private or governmental banks making loans to the private sector of the economy.

Although development planning and the implementation of plans must be the basic responsibility of the governments of the developing countries, external assistance agencies should play an important role in influencing the character of planning. This is particularly impor-

tant if development assistance is to be directed toward the promotion of balanced growth for the economy as a whole rather than simply the financing of specific projects, and if the operations of the various financial and technical assistance agencies operating within the country are to be consistent with one another and with other projects undertaken independently of outside assistance. Development plans are also closely related to, and indeed must include provision for, the various types of social programs, including rural resettlement, housing, and slum clearance. Monetary and fiscal policies also play a vital role in development planning. Changes in the system of taxation are important not only for their contribution to overall growth, but to social development.

Our aid administrators cannot sit behind their desks and review projects for economic and social development as they are presented by governmental agencies or private organizations in the developing countries. They must play an active part in influencing the character of development programs at various levels, from the determination of the broad outline or pattern of a country's future growth to a consideration of specific projects to be financed. Much of our success in using development assistance as an incentive to self-help and social reform will depend upon the diplomatic skill of the U.S. mission chiefs and their staffs in the developing countries, and upon the relationships which they are able to build with local officials. It is important that country missions be supported and not be undercut by the State Department or the White House as a consequence of diplomatic end-runs undertaken by prime ministers or presidents of foreign countries coming to Washington for financial assistance rather than going through channels. Success in influencing the character of development planning rests very heavily upon day-to-day contacts and operations of the country mission chiefs and their staffs. But since the U.S. AID mission is not the only group operating in the developing countries, there must be the fullest possible coordination between the activities of the U.S. mission and those of the multilateral development assistance agencies.

There are many aspects of this whole field of self-help and economic and social reform in the developing countries which are so delicate and so highly charged with political overtones that the U.S. mission may not always be the best agency to take the initiative in discussing and seeking to influence policies with the host governments. Mention has already been made of the use of the IMF in connection with stabilization programs. In the field of tax reform, which is so urgently needed in nearly all Latin American countries, it may be that the Inter-American Economic and Social Council is the best agency to give advice and technical assistance in this field; while in the field of land reform, the U.N. Food and Agriculture Organization may be the most appropriate agency to take the initiative. However, the various financial assistance and other technical assistance agencies all have an interest in the kinds of advice and assistance that is to be rendered in these areas. Thus, for example, the financing of a rural improvement program cannot be separated from the land tenure problem. This again emphasizes the importance of coordination of the activities of the various development assistance agencies at the country level.

C. INSTITUTIONS FOR DEVELOPMENT ASSISTANCE

1. Bilateral, regional, and international institutions

U.S. funds for development assistance are channeled through a bewildering complex of bilateral, regional, and international agencies, and in many countries the provision of external assistance is complicated by the existence of multilateral institutions such as the Development Fund of the European Economic Community, various foreign assistance agencies of European governments, and a number of private agencies providing various forms of technical assistance. While some of the new public lending institutions that have been created over the past few years can certainly be justified as filling functional gaps in our kit of development therapies, few would argue that our national and international structure of foreign assistance agencies constitutes a rational pattern. However, since unscrambling this untidy structure would involve legislation, not only by the United States but by 60 or 70 other countries as well, we shall probably have to live with it and find means of coordinating the activities of these manifold agencies. But before taking up this problem, it seems desirable to consider briefly the relative merits of bilateral, regional, and international institutions. This is important for two reasons: first, because the United States can, and has, changed the emphasis in its own aid program as among these three types of organizations; and, second, because it is quite possible that we will see proposals for additional regional organizations as well as additional international ones.

Although the United States has been channeling more of its aid dollars through multilateral organizations in recent years, the administration's new AID program does not indicate a substantial change in the proportion of our total development assistance to be administered by multilateral agencies. Three basic reasons have been given for continuing to provide the bulk of U.S. economic assistance to underdeveloped countries on a bilateral basis. First, there is the traditional argument that foreign aid as a tool of our foreign policy can be used with greater flexibility and more effectively in achieving foreign policy ends if it is made available on a bilateral basis. While this is certainly true in the case of "supporting assistance" and also in the case of assistance made available from the President's contingency fund for dealing with emergency problems where vital political interests are concerned, there is considerable doubt as to whether the political argument is of major significance for long-range development assistance. For example, why could we not use the International Development Association to perform the same functions as the new Agency for International Development in making virtually the same type of development loans? An argument against this suggestion is that IDA's funds are limited compared with those of AID and that we may not want to change the proportion of the U.S. contribution to IDA in relation to that of other developed countries. On the other hand, we could make additional resources available to IDA without changing its basic structure through a trust agreement by which U.S. funds would be turned over to IDA for use in making development assistance loans. This was the procedure employed by the United States in making available the $394 million social progress fund for Latin America to the Inter-American Development Bank as the administering agency.

A second reason given for having a large bilateral aid program together with a well-staffed mission in each country is that only by this means can the United States exert a larger leadership role in coordinating the assistance activities of all free world agencies, multilateral and bilateral. In other words, this assumes that the agency with the largest amount of money to spend, and perhaps the largest staff, will have the dominant voice in determining development assistance policies generally. We shall examine this argument in the following section.

The third reason for favoring bilateral over multilateral assistance is that it is easier to tie bilateral assistance to U.S. exports than in the case of financial contributions to multilateral agencies. This argument, of course, cuts both ways; that is, other countries providing development assistance on a bilateral basis are also tying their aid to their own exports. If we go on the assumption that the United States will provide the vast bulk of the development assistance, this argument has some merit. On the other hand, if in the longer run this is not true and if in addition the United States expects its exports to be competitive in world markets, it might be to our advantage to make our aid available on an untied basis through multilateral agencies. Finally, it is quite possible to tie contributions to a multilateral assistance agency to U.S. exports. For example, in the case of the Social Progress Trust Fund administered by the IDB, the dollars must either be spent in the United States or for making purchases in other Latin American countries.

While recognizing that the United States will always have need for a reasonable amount of aid funds to be employed directly as a tool of U.S. foreign policy, there are rather compelling reasons why we should move in the direction of multilateral administration of development assistance. First, we have come to recognize that the promotion of economic development requires a long-range program in which various types of aid are coordinated and employed to promote self-help measures in the developing country. In this context long-range development assistance has limited usefulness in achieving short-term political advantages or concessions from developing countries, which would be of special interest to the United States as against the general interest of the Western World in maintaining stability, independence, and democratically inclined governments in the less developed areas. In those cases where there are special U.S. political interests to be served, we should, of course, be prepared to promote them by supplementing multilateral with bilateral assistance.

A second reason favoring a move to multilateral assistance has to do with the longrun relative economic position of the United States vis-a-vis the rest of the free world. In spite of the rude shock caused by our balance-of-payments deficit and in spite of the high rates of economic growth in the industrialized countries of Western Europe and Japan relative to our own, the Government and the people of the United States are still somewhat inclined to view our economic power position as relatively little changed from that of the late 1940's or early 1950's. Although the job of keeping the free world free has grown enormously with the expansion of the economic and military power of the Sino-Soviet bloc, our own relative capabilities have grown weaker. Our gross national product as a percentage of the combined gross national product of the developed countries of the

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free world has been declining steadily, as has also our proportion of world markets. While we should not in any way relax our position as a world leader, our leadership must be based more and more on our ability to mobilize and coordinate the resources of the free world and less upon a position of relative economic power which will continue to decline in the future. But before we can convince our allies that they must assume a much larger share of the financial burden and responsibility for development assistance, we must give up the idea of formulating large bilateral development aid programs designed to carry the lion's share of achieving free world goals with perhaps only peripheral assistance from other sources. Regardless of whether or not our administration has adopted this philosophy, a foreigner reading the administration's presentation to Congress entitled "An Act for International Development, a Summary Presentation" (June 1961) might well get the impression that the United States has the major responsibility for guiding economic progress in the less developed countries.

Our third reason for favoring a shift to multilateral assistance relates to the problem of coordination of development assistance activities. Should the responsibility for such coordination at both the country and the agency level lie with the U.S. Government and its country mission chiefs, or with a multilateral organization, either regional or international? As we shall indicate in the paragraphs below, there are good reasons to believe that in the long run this responsibility should lie with multilateral institutions.

2. Coordination of foreign aid policies and operations

For many years specialists in the field of foreign aid have been pointing to the difficulties in promoting economic development within the framework of a rational plan for achieving economic and social goals, given the existence of nearly a score of external financing and technical assistance agencies, all operating within the same country and with little or no coordination at the country level.[8] This is a problem which has involved not only the relationship between U.S. agencies on the one hand, and multilateral and other national and private agencies on the other, but there has been a problem of coordination among the U.S. agencies themselves. There are three levels at which coordination is needed: (1) policy and operational coordination among the officials in the central offices of the development assistance agencies in Washington, the United Nations, and the European centers; (2) coordination of policies and operations at the country level, both with respect to the functions of the agencies themselves and in their dealings with the officials of the host country; and (3) coordination, such as that carried on by the Development Assistance Group (DAG), among the governments of the major capital exporting countries, or among government officials in organizations such as the Organization for American States which includes both donor and recipient countries. The latter organizations must be concerned with broad policy problems relating to long-range goals for groups of countries, with the sharing of the aid burden, and with the extent to which assistance should be provided through multilateral or bilateral agencies.

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[8] See statement of Harlan Cleveland, "The American Overseas," hearings before the Committee on Foreign Relations, U.S. Senate, 86th Cong., 1st sess., Feb. 18, 1959, Washington, D.C.

Turning first to the problem of high-level coordination among the actual development agencies, there are a number of formal and informal organizations and channels through which this coordination takes place. The fact that there is a concentration of both United States and multilateral financial and technical assistance agencies in Washington, D.C., simplifies this problem. There is the coordination achieved through the activities of the National Advisory Council on International Financial and Monetary Problems, which reviews proposed loans and significant policy questions relating to the operations of both the various U.S. agencies and of multilateral agencies such as the IMF, the World Bank, IDB, IDA, and IFC, of which the United States is a member. In addition direct channels of communication and coordination have been established among these agencies. In a number of cases "package" aid programs have been arranged for individual countries involving two or more agencies. Officials of various agencies interested in a particular country have consulted one another before acting on loan requests and efforts have been made to standardize loan terms such as interest rates on hard loans. These agencies also exchange information and views on questions relating to a given country's capacity to service additional foreign loans or the soundness of their development programs and projects.

At the outset the Kennedy administration recognized the need for coordination and consolidation of U.S. governmental assistance activities and the new AID program reflects, in part at least, a concern for this need. Under the new Agency for International Development there will be a closer coordination of technical and financial assistance in relation to promoting economic development within the framework of sound economic planning and self-help measures. The present activities of the ICA and of the DLF are consolidated in the new Agency. (There was strong pressure within the administration—at least at an earlier stage of the aid planning—to include the development loan activities of the Export-Import Bank together with the Peace Corps and the food-for-peace program in AID. However, for various political and administrative reasons, this was not done.)

As has already been noted, the most serious problem of coordination—and one which has not been satisfactorily dealt with—is that of coordinating the financial and technical assistance activities of all agencies, bilateral, and multilateral, at the country level. If the basic approach outlined in the administration's summary presentation of the AID program, which emphasizes long-run assistance programs closely related to and integrated with national development plans and designed to promote self-help activities on the part of the countries themselves in achieving well-defined economic and social goals, is to be implemented, then country-level coordination of all free world development assistance activities is absolutely essential. Specifically, such coordination must include: (*a*) an agreement on investment priorities in relation to medium- and long-term social and economic goals; (*b*) a coordinated review and common recommendations to local government officials with respect to individual country plans and programs; (*c*) coordination of long-term commitments of external funds called for by the country's development plan; (*d*) coordination between the technical assistance agencies helping a country to formulate projects for external financing and the external financial institutions; (*e*) agreed positions with respect to the country's capacity to service

foreign indebtedness so as to determine a proper overall relationship between hard loans, soft loans, and grants; and (*f*) agreed positions on recommendations to the country with respect to its internal monetary and financial policies.

There have been a few examples of country-level coordination of certain aspects of the development assistance programs for certain countries. For example, a consortium of countries is contributing to the Indus waters program in India and Pakistan under the aegis of the World Bank. The countries include the United States, the United Kingdom, Australia, Germany, New Zealand, Pakistan, and India.

The charter of the Punta del Este Conference, adopted at the meeting of the Inter-American Economic and Social Council of the OAS in August 1961, provides machinery for close cooperation among the OAS, the U.N. Economic Commission for Latin America, and the Inter-American Development Bank, in reviewing development programs for promoting economic and social development in the Latin American Republics. The charter established procedures for the review of development programs of individual countries by independent experts drawn from a panel of nine high-level experts nominated jointly by the OAS, Inter-American Development Bank, and the U.N. Economic Commission for Latin America. Each government, if it so desires, may present its program for economic and social development for consideration by an ad hoc committee composed of no more than three members drawn from the panel of experts, together with an equal number of experts not on the panel. This committee will study the country's development program in consultation with the interested government with a view to possible modifications, and—

> "with the consent of the government, report its conclusions to the Inter-American Development Bank and to other governments and institutions that may be prepared to extend financial and technical assistance in connection with the execution of the program" * * * "A government whose development program has been the object of recommendations made by the ad hoc committee with respect to external financing requirements may submit the program to the Inter-American Development Bank so that the Bank may undertake the negotiations required to obtain such financing, including the organization of a consortium of credit institutions and governments disposed to contribute to the continuing and systematic financing, on appropriate terms, of the development program. However, the government will have full freedom to resort through any other channels to all sources of financing, for the purposes of obtaining in full or in part, the required resources."

While the voluntary system of review summarized above may lead to better planning and may in some cases provide a mechanism for bringing pressure on governments to undertake economic and social reforms as a condition for obtaining external assistance, the procedure falls far short of full coordination of the activities of external assistance agencies at the country level. Moreover, a review of broad economic and social development programs is by no means the same as a review of the underlying projects to be financed. Thus the Punta del Este Conference did not provide for the type of operational coordination at the country level which was suggested above.

3. Proposal for country-level coordination

What kind of machinery is needed for the coordination of development assistance agencies at the country level along the lines indicated above? Obviously it would not be desirable to adopt identical machinery for each country, and indeed, for a few countries where

development is proceeding satisfactorily with only an occasional loan from the World Bank or the Export-Import Bank, no special coordinating machinery may be required. However, in other countries where a number of agencies are operating and where development progress has not been assured, such machinery might include among other things a committee on which all external agencies operating in the country were represented, with power to make specific joint recommendations directly to the headquarters of each of the agencies represented, as well as to high-level coordinating groups in Washington or elsewhere. The job of the committee would be to review development programs and requests or recommendations for various types of assistance and to reach agreed positions in connection with all negotiations with officials of the host country. Such negotiations might continue to be carried on by individual agencies or they might be conducted by representatives of the committee which would be chaired by the assistance agency most concerned. Since each independent foreign assistance agency is autonomous in its own field, it presumably could not be forced to take an action or refrain from doing so, but the combined decision of a coordinating group operating in the country would normally carry considerable weight.

A system of country-level coordination of the type outlined above would undoubtedly require some reorganization of existing coordinating machinery among the officials of the agencies themselves at the Washington level. However, the whole approach to development assistance in terms of a close and continuous relationship to the development programs of individual countries requires a considerable shift of authority from the headquarters of the aid organizations to the country missions. This represents a problem for virtually all multilateral institutions since they do not have—except in a few cases—resident offices in the developing countries. It is perhaps desirable that they have such offices, although one officer might conceivably be a representative for several African or Latin American countries. In any event, each of the important assistance agencies should have an official who would be in more or less continuous contact with the country committees and with the development activities of one or more countries themselves.

Coordinating machinery of the type proposed above is not likely to succeed in the absence of strong leadership, and there will be a tendency for the agency or agencies with the largest programs, and those with officials having the greatest influence and close and continual relationship to the developing country and its officials, to exercise this leadership. Thus both the country coordinating machinery and the leadership would tend to differ from country to country. Where a strong regional organization exists, such as we hope will be the case in Latin America, it is possible that the IDB, or conceivably a regional OAS representative, may provide both the close and continuous relationship with the host government and the leadership of the coordinating machinery. In India, on the other hand, the World Bank, which has a regional office in India and has taken the initiative in the organization of aid consortiums, may occupy this leadership role. It should not be assumed, therefore, that USOM will or should necessarily dominate the coordinating machinery and its policies. We may also raise the question as to whether leadership at the country level should, over the longer run, be centered in the U.S. mission or whether it would be

more effective if that role were performed by an international institution such as the World Bank or a regional organization such as the IDB or the OAS. The answer to this question is closely related to that of whether the bulk of U.S. development assistance should be made available on a bilateral basis or channeled through international and regional agencies. Although individual country situations differ and will undoubtedly change over time, it is believed that in most cases the locus of responsibility and leadership in the coordination of aid programs in individual developing countries should be in an international or regional institution. Such an arrangement is likely to be more successful if the dominant institution in the coordinating organization also administers the largest economic assistance program. We are led to this view in part because we believe that international organizations will be more effective in influencing the internal policies of developing countries.

D. SHARING THE AID BURDEN

1. How much aid for development assistance?

Determining the amount of development assistance which an individual country or all of the countries which comprise the underdeveloped category will require over a period of years in order to achieve a condition of self-sustaining economic growth, involves not only a highly speculative calculation, but in a certain sense the problem is incapable of solution. There are two basic reasons for this observation. We have rejected any mechanical relationship between the volume of external capital and the rate of economic growth. Growth is a complex function of a large number of social and economic factors including the quality of the labor supply, natural resource endowments, social attitudes toward achievement and accumulation, the amount of entrepreneurial talent, and the quality and motivation of governmental administration at all levels. It must also be emphasized that financial capital, whether derived from domestic or external sources, is not synonymous with an equivalent amount of capital formation. Enterprises, public or private, may borrow funds to finance a portion of their investment, but whether over a period of time there is an increase in capital formation equal to, greater than, or less than the amount of funds borrowed cannot be determined in advance. Still less can we know what the impact on actual capital formation will be from an inflow of financial capital to the country as reflected in the balance of payments. The ability to transform external financial capital into real capital assets which, combined with other factors of production, produce a net increase in total output is sometimes spoken of as the "capital absorptive capacity" of a country. Much can often be done by means of technical assistance and external advice to expand the capital absorptive capacity of a country, but again, this cannot be determined in advance.

A second obstacle to the calculation of the amount of development aid needed to achieve reasonable growth rates is that development assistance is basically a matter of helping countries to help themselves. This point has been emphasized in the new AID program. What countries will be able to obtain from external financing agencies is therefore in considerable measure a function of their willingness and ability to take the necessary self-help measures for mobilizing their

resources, together with undertaking social reforms designed to remove social injustices and inequities and provide broader opportunities for the great masses of people in the developing countries.

If we were not interested in achieving long-range economic and social development goals, there would be almost no limit to the amount of funds that developing countries could use for meeting balance-of-payments deficits arising from foreign expenditures of all types in excess of their receipts from imports. But the wise employment of funds directed solely toward helping countries achieve these development goals establishes a limit, however uncertain, upon the amounts that can be effectively used in our foreign aid programs. These amounts can only be determined on the basis of experience over a period of several years. (It will be recalled that the achievement of the Marshall plan goals required less than half of the amount of assistance originally calculated as necessary to do the job.) Meanwhile, it is suggested that the best answer to the question of how much the United States and the other developed countries should be prepared to provide for assisting developing countries in achieving reasonable rates of economic growth and the broadest measure of social progress consistent with their resources is *all the material and technical assistance which can be productively employed for mobilizing and increasing the efficiency of the human and material resources of the developing countries.*

It is undoubtedly true that in the field of social development, such as housing, education, etc., the limits of capital absorptive capacity are much more flexible. On the other hand, it would be unwise to undertake social programs which involve a substantial measure of consumption, as against investment for increased output, out of line with a country's ability to maintain such services from future output. To take an extreme case, it would not be wise to provide housing for workers or school buildings similar to those which exist in the United States for countries whose per capita incomes are $200 or $300 per year.

While recognizing the uncertainties and experimental nature of the problem of determining the amount of external assistance necessary to achieve our goals in the developing countries, as a practical matter appropriations must be requested from Congress and multilateral institutions must have some idea of the funds that they will require over the next few years. The sums requested by the administration for the fiscal 1962 AID program and the 5-year development loan program aggregating some $8.8 billion were based on rough estimates of the absorptive capacity of developing countries together with what these countries may be expected to obtain from other development assistance agencies. However, it must be emphasized that only experience in providing assistance within the framework of long-range development plans can provide a basis for the external financial requirements for meeting our goals in the developing countries. Again, this approach argues for maximum flexibility in making aid available over a period of several years. The administration's new approach to development assistance is completely inconsistent with annual aid appropriations, and this applies to development grants as well as to loan assistance.

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2. Sharing the aid burden among developed countries

The shift in the relative economic position of the United States over the past decade as a consequence of rapid growth in Western Europe and Japan, together with recent balance-of-payments difficulties of the United States caused in part by our large economic aid and military expenditures abroad, have led the United States in cooperation with other industrialized countries to give serious consideration to the problem of how foreign aid should be shared. European powers, such as Belgium, France, the Netherlands, and the United Kingdom, which either administer territories in underdeveloped areas or maintain close economic and political ties to former colonial areas which have recently become independent, have been providing substantial amounts of loan and grant assistance, and in addition have contributed to international institutions such as the World Bank and IDA and to regional institutions such as the Oversea Development Fund of the European Economic Community. On the other hand, countries which have not had special ties with oversea territories have until recently, at least, contributed relatively little to development aid beyond their subscriptions to international institutions.

The problem of determining what a country's fair share of the aid burden should be is a very difficult one. To begin with, there is a problem of defining "aid" itself, since many credits to less developed countries are made available primarily for the purpose of financing exports. In the "Summary Presentation" to the Congress, comparative data on bilateral aid were limited to "net grants and gross loans of over 5 years original maturity." [9] This excludes private loans and grants and contributions to international institutions. Contributions to international institutions present special problems in measuring a country's aid burden, since some countries' local currency subscriptions are employed to a greater extent than others, and in the case of organizations such as the World Bank, a large portion of the subscriptions are not callable except in case of default and constitutes, in effect, an underwriting of the Bank's loans.

Once the problem of defining aid has been resolved, it is necessary to determine a basis for equitable sharing. The usual approach is to relate the amount of a country's aid to its gross national product. But should Japan—whose real GNP per head is less than a fourth that of the United States—or a Western European country—whose real per capita output may be less than half that of the United States—be expected to provide the same percentage of its GNP in the form of aid to developing countries as the United States? Should we, in effect, apply the principle of progressive taxation to nations just as we apply it to taxation of individuals in this country?

These are some of the questions which the representatives of the member nations of the Development Assistance Group (DAG) have been struggling with. Thus far 10 governments have become members of DAG—the United States, Britain, Canada, France, West Germany, Italy, Belgium, the Netherlands, Japan, and Portugal—but it is expected that other OECD members will join DAG (which is to become the Development Assistance Committee (DAC) of the OECD)

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[9] See "An Act for International Development, a Summary Presentation," June 1961, p. 144. This does not represent the administration's definition of "aid," but the concept was employed on the basis of the availability of the data.

in the near future. The purpose of DAG is to expand the volume of resources available to the less developed countries, to improve the effectiveness of the aid, and to provide a means of coordinating the bilateral assistance programs of various developed countries together with that of the multilateral programs. Through DAG and other channels, the United States has worked to increase the volume of German aid for developing countries. For example, in 1959 Germany's official bilateral grants and loans to developing countries (loans with maturities of over 5 years) totaled only $72 million,[10] and if contributions to international organizations are included, Germany's total foreign aid was under $100 million. This constituted 0.16 percent of Germany's GNP for 1959 as against a U.S. contribution of over $2.4 billion, or approximately one-half of 1 percent of U.S. GNP in 1959. During the period 1961 and 1962 German contributions to foreign aid are scheduled to amount to $1,250 million, or about 1 percent of Germany's GNP.[11]

Table I shows the private and governmental capital flows and official foreign aid contributions of members of DAG for the years 1956 through 1959, as a percentage of the gross national product of the individual members. Table 2 provides data on GNP and loan and grant commitments for a few countries for 1960. It will be observed that although for most years the relative foreign aid contribution of the United States compares favorably with that of other DAG countries as a group there were wide differences in the contributions of individual countries as a percentage of their GNP. (Foreign aid is defined as "grants and loans of 5 years or more maturity and contributions to international development assistance orgaizations.") There is a question of whether or not account should be taken of private capital flows in measuring and comparing contributions to less developed countries, and in this item, as well as in total capital flows, the U.S. contribution as a percentage of GNP has in most years been substantially less than that of the other DAG countries combined. Direct private capital investment, while in many cases making an even more important contribution to economic growth abroad than public loans, provides special advantages to the capital exporting countries, particularly since they are heavily concentrated in the extractive industries. On the other hand, private capital flows do constitute a transfer of resources from the capital exporting to the capital importing countries just as is the case with official foreign assistance.

Still another problem which must be dealt with in devising an equitable formula for sharing the aid burden has to do with the statistical difficulties in making comparisons between the gross national products of the capital exporting countries. It has long been recognized by specialists in the field of national accounting that comparisons of monetary values of GNP by converting them into a common currency unit at existing exchange rates do not reflect differences in real output. Table 3 compares estimated GNP in U.S. dollars with real GNP for several developed countries for 1960. Real GNP for countries other than the United States indicates the value

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[10] Ibid., p. 160.

[11] "International Development and Security," hearings, U.S. Senate Committee on Foreign Relations, 87th Cong., 1st sess., pt. 1, p. 162. Some of the German contributions represent disbursements of funds committed in prior years.

of their GNP in terms of U.S. prices. For most countries real GNP is substantially higher than GNP derived by converting the local currency value of the product into dollars at current exchange rates. Thus if we assume that the foreign aid made available by the various DAG members represents the dollar value of the assistance in terms of international prices, the burden of the foreign aid measured as a percentage of nominal GNP in tables 1 and 2 may overstate the real burden of the foreign aid for most other DAG members in comparison with that of the United States.

On the other hand, it may be argued that countries with higher per capita incomes should assume a proportionately higher share of the aid burden in accordance with the principle of progressive taxation. In an analysis of the problem of determining the proper U.S. share of foreign aid, Dr. P. N. Rosenstein-Rodan of the Center for International Studies, Massachusetts Institute of Technology, calculates the ratio of U.S. GNP to the combined GNP of all countries capable of providing development assistance to be 54 percent.[12] After applying the principle of progressive income taxation to per capita real GNP for these countries, Dr. Rodan concludes that as of 1961 the United States should contribute about 65 percent of total aid, leaving 35 percent to Europe, Oceania, and Canada. Dr. Rodan excludes Japan from the countries capable of providing development assistance.

The purpose of the foregoing discussion has been to illustrate the problems in the determination of how the aid burden should be shared rather than to recommend any particular formula. We are confronted with even more difficult problems in deciding which countries are eligible for development assistance. These would appear to be matters for high-level policy discussions among the major industrialized countries and in consultation—on certain points at least—with representatives of the developing countries themselves. This discussion again suggests the advisability of moving more in the direction of multilateralized assistance.

3. Development aid sharing, and the balance of payments

Of the approximately $5 billion in grants and long-term loans provided by the industrialized OEEC countries, Canada, and Japan during the 1956–59 period, three-fourths was in the form of grants and the remainder in long-term loans. Some countries generally tie their loans and grants to domestic procurement. These countrie include Austria, Canada, Japan, Italy, and France. Although formerly much of Germany's aid had been tied in one way or another, it is reported that new German financial credits are not tied to the purchase of German exports. Belgium, the Netherlands, and Portugal also do not as a rule tie procurement to their exports.[13]

In the past a substantial portion of U.S. development assistance has been untied, but recently measures have been taken to increase

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[12] Free world countries capable of providing development assistance, according to Dr. Rodan, include Belgium, Canada, Denmark, Finland, France, Germany, Italy, Luxembourg, Netherlands, Norway, Oceania, Sweden, Switzerland, the United Kingdom, and the United States. See P. N. Rosenstein-Rodan, "International Aid for Underdeveloped Countries," the Review of Economics and Statistics, May 1961, pp. 111, 138.

[13] See the "International Development and Security Act," hearings, House Committee on Foreign Affairs, 87th Cong., 1st sess., on H.R. 7372, pt. 2, 1961, p. 818.

the portion of our development assistance which is tied to procurement in the United States. However, the fact the aid is tied does not necessarily mean that there will be no adverse impact upon the balance of payments of the donor country. Even if we were to insist that every dollar made available under our aid programs be spent for U.S. exports, we cannot be sure that these exports represent a net addition to our total exports; and to a considerable degree, the aid that we provide releases other dollar income accruing to the developing countries which they can then use for purchases outside of the United States. Hence, Secretary of the Treasury Dillon's statement that "Our objective will be to insure that at least 80 percent of our foreign economic assistance will be spent on U.S. goods and services" [14] does not necessarily mean that the adverse effect on our balance of payments arising from our foreign economic assistance program will be no more than 20 percent of the value of our aid. It could be less than 20 percent, and it might well be a good deal more, depending upon the competitiveness of our exports in world markets.

Ideally all financial assistance should be untied in the sense that within the purposes of the project to be financed the foreign recipient should be permitted to purchase goods and services in any part of the world on the basis of price and quality. This would not only increase the efficiency of our aid dollars, but is also in harmony with free market principles for the allocation of resources which we in free enterprise economies believe to be highly desirable for ourselves and will produce the most efficient allocation of resources within the developing countries. If the principle of buying in the cheapest market is valid for internal economic relations, it should be equally so for the free world as a whole. Moreover, if all capital exporting countries were to make available their development assistance on an untied basis, we would have an equal opportunity to supply the commodities purchased with the aid funds, whatever the source of the funds might be. Since the developing countries are not likely to accumulate substantial amounts of foreign exchange reserves, competition for markets in the developing countries—and hence for a portion of the aid dollars—would be on much the same basis as if there were no aid dollars being made available except for the fact that the markets are larger. Thus, given a reasonably equitable distribution of the aid burden from the standpoint of the total funds to be made available, the existence of aid in an untied form should constitute no special burden or drain upon the U.S. balance of payments. Aid or no aid, we must balance our international accounts by becoming sufficiently competitive in international markets to match our outflow of foreign exchange payments with our inflow. Part of our difficulty in the past has been that while much of our own aid has taken an untied form, nearly all of the bilateral, and some of the multilateral, assistance provided by other countries has been tied. In addition, we have been making large military expenditures abroad for commodities and services that do not ordinarily enter into international trade.

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[14] "International Development and Security," pt. 1, op. cite pp. 94–95.

TABLE 1.—*Capital flows from DAG countries to less developed countries as percentages of GNP, 1956–59*

[Percentages]

Country and category	1956	Percent of GNP		
		1957	1958	1959
Total, DAG countries:				
Total, capital flows	0.90	1.02	0.99	0.86
Total official capital flows	.48	.52	.60	.56
Grants and loans of 5 years or more and contributions to international organizations	.47	.50	.56	.52
Total, private capital flows	.43	.51	.39	.30
United States:				
Total, capital flows	.77	.93	.83	.63
Total, official capital flows	.48	.47	.55	.48
Grants and loans of 5 years or more and contributions to international organizations	.51	.53	.54	.51
Total, private capital flows	.29	.45	.28	.15
Total, other DAG countries:				
Total, capital flows	1.12	1.18	1.24	1.24
Total, official capital flows	.47	.59	.67	.69
Grants and loans of 5 years or more and contributions to international organizations	.40	.46	.59	.54
Total, private capital flows	.64	.59	.56	.55
Belgium:				
Total, capital flows	.78	.30	1.02	1.44
Total, official capital flows	.12	.16	.20	.79
Grants and loans of 5 years or more and contributions to international organizations	.19	.18	.21	.44
Total, private capital flows	.67	.14	.82	.64
Canada:				
Total, capital flows	.32	.38	.44	.30
Total, official capital flows	.10	.14	.27	.16
Grants and loans of 5 years or more and contributions to international organizations	.10	.14	.27	.16
Total, private capital flows	.22	.24	.17	.13
France: [1]				
Total, capital flows	2.09	2.13	2.26	2.45
Total, official capital flows	1.22	1.48	1.58	1.62
Grants and loans of 5 years or more and contributions to international organizations	1.29	1.52	1.65	1.68
Total, private capital flows	.86	.65	.67	.83
Germany:				
Total, capital flows	.93	1.07	.96	1.35
Total, official capital flows	.34	.58	.52	.70
Grants and loans of 5 years or more and contributions to international organizations	.04	.09	.14	.14
Total, private capital flows	.59	.49	.44	.65
Italy:				
Total, capital flows	.50	.71	.42	.53
Total, official capital flows	.12	.51	.12	.33
Grants and loans of 5 years or more and contributions to international organizations	.09	.06	.12	.06
Total, private capital flows	.38	.20	.30	.20
Japan:				
Total, capital flows	.45	.34	.89	.41
Total, official capital flows	.35	.25	.77	.28
Grants and loans of 5 years or more and contributions to international organizations	.02	.06	.79	.22
Total, private capital flows	.10	.09	.12	.13
Netherlands:				
Total, capital flows	3.30	1.44	2.17	2.19
Total, official capital flows	.61	.12	.49	.71
Grants and loans of 5 years or more and contributions to international organizations	.42	.33	.43	.45
Total, private capital flows	2.69	1.32	1.68	1.48
Portugal:				
Total, capital flows	2.18	2.08	2.00	2.63
Total, official capital flows	.16	.10	.05	.78
Grants and loans of 5 years or more and contributions to international organizations	.36	.25	.20	.97
Total, private capital flows	2.02	1.98	1.95	1.84
United Kingdom:				
Total, capital flows	1.03	1.48	1.36	1.17
Total, official capital flows	.34	.36	.53	.54
Grants and loans of 5 years or more and contributions to international organizations	.36	.40	.41	.54
Total, private capital flows	.68	1.13	.82	.63

[1] Gross national product and capital flows converted to dollars at exchange rates in existence during year.

Source: International Development and Security, hearings, Committee on Foreign Relations, U.S. Senate, 87th Cong., 1st sess., on S. 1983, pt. I, May and June, 1961, pp. 193–194.

TABLE 2.—*GNP and commitments of loans and grants for selected countries to less developed areas, 1960*

[Millions of U.S. dollars]

Country	GNP at current prices (estimated)	Commitments			Total commitments as percent of GNP
		Loans over 5 years	Grants	Total loans and grants	
U.S.S.R.[1]	226,000	1,084	11	1,095	0.48
West Germany	66,720	209	44	253	.38
Japan	36,715	50	142	192	.52
France[2]	56,260	87	687	774	1.38
Italy	30,785	52	2	54	.17
United Kingdom	69,160	223	158	381	.55
Canada[2]	35,300	----------	58	58	.16
United States	503,200	[3] 2,028	[4] 1,796	3,824	.78

[1] Excludes loans and grants to Soviet bloc countries.
[2] Disbursements; commitments not available.
[3] Includes DLF, ICA, Public Law 480 (title I), and Export-Import Bank.
[4] Includes MSP (ICA), Public Law 480 (titles I, II, and III), and other (malaria eradication, etc.).

Source: The International Development and Security Act, hearings, House Committee on Foreign Affairs, 87th Cong., 1st sess., on H.R. 7372, June 1961, pt. II, p. 819.

TABLE 3.—*GNP and real GNP for selected countries, 1960*

[Billions of U.S. dollars]

Country	GNP at current prices (estimated)[1]	Real GNP in U.S. dollar equivalents[2]
West Germany	66.7	93.4
Japan	36.7	69.8
France	56.3	67.2
Italy	30.8	43.1
United Kingdom	69.2	89.9
Canada	35.3	35.3
United States	503.2	503.2
U.S.S.R.	226.0	271.2

[1] GNP estimates for foreign countries prepared by U.S. Department of State. See the International Development and Security Act, hearings, House Committee on Foreign Affairs, 87th Cong., 1st sess., on H.R. 7372, June 1961, pt. II, p. 819.
[2] Real GNP indicates the purchasing power of the GNP in terms of U.S. prices. They were calculated on the basis of weights derived from comparisons between GNP and real GNP prepared by Dr. P. N. Rosenstein-Rodan in "International Aid for Underdeveloped Countries," the Review of Economics and Statistics, May 1961, pp. 118 and 138. For alternative calculations of real GNP, see Everett E. Hagen, "Some Facts About Income Levels and Economic Growth," Review of Economics and Statistics, February 1960.

PART III

THE ROLE OF PRIVATE FOREIGN INVESTMENT IN ECONOMIC DEVELOPMENT

(By Raymond F. Mikesell)

A. CONTRIBUTION TO ECONOMIC DEVELOPMENT

As has been the case with past administrations, President Kennedy's new AID program rightly stresses the importance of the role of U.S. private investment in the economic growth of developing countries. In recent years Government capital flow from the United States to the poorer countries of the world has been somewhat larger than private capital outflow. However for other members of DAG, total private capital flow to the less-developed countries has been nearly as large as official capital outflow. (See pt. II, table 1.) But more important than the volume of private capital outflow is the fact that private capital is accompanied by technical and managerial skills and entrepreneurial activities which are of the greatest importance in mobilizing the human and material resources of the less-developed countries for greater output. Thus in terms of the overall effectiveness of external assistance in increasing output of the less-developed countries, a private dollar in the form of direct private investment may be several times more effective than a public dollar. However, this is not to argue that all external capital flows to the less-developed countries should be in the form of private investment. There are many fields in which foreign private capital is either not interested or, as in the case of most social development projects, private capital investment would not be appropriate. Moreover, for one reason or another, many industries in less-developed countries, such as public power and railroad transportation, are operated by government. Thus, in most situations it is not a question of either private or public capital for maximizing growth and social progress in developing countries, but of providing the largest volume of both in their appropriate fields, which can be productively employed for achieving development goals.

1. Pattern of U.S. foreign investment flow

During the postwar period, 1946–60, total book value of U.S. direct investment abroad rose by $27.5 billion of which $15.6 billion represented increased investment in the relatively high-income countries, and $8.5 billion in the low-income countries. (Relatively high-income countries include Canada, Western Europe, Japan, and Oceania—see table 1.) The remainder was accounted for by international shipping. Of the $8.5 billion increase in U.S. investment in low-income countries, Latin America accounted for $6.3 billion during the 1946–60 period. There was an increase of about a billion dollars

in the value of U.S. direct investments in the Middle East (mostly in petroleum) and another billion dollars in the low-income countries of Africa and Asia. Thus the increase in the value of U.S. direct investments in the low-income countries outside of Latin America constituted less than 10 percent of the total increase in U.S. direct investments during the postwar period. Moreover, if we exclude U.S. petroleum investments in the Middle East, less than 5 percent of total U.S. private investment is to be found in the critical areas of Asia and Africa. For example, at the end of 1960 the book value of U.S. private direct investment in India was only $159 million. It should also be mentioned that whereas nearly half of U.S. direct investments in the relatively high-income areas was in manufacturing, only 14 percent of our direct investment in the relatively low-income area was in manufacturing. Moreover, the vast bulk of U.S. investment in manufacturing in the low-income areas is in Latin America; outside of Latin America, U.S. direct investment in manufacturing in 1960 had a book value of less than $200 million.

The implications of this pattern of U.S. private investment for the achievement of our objectives in developing areas, particularly outside of the few relatively advanced countries in Latin America, are rather obvious. U.S. direct investment is simply not making an appreciable contribution to economic development in Africa and Asia outside of a handful of petroleum producing countries, and it can, and should, be making a larger contribution to economic development in Latin America.

2. What kind of private investment do developing countries want?

Before considering specific governmental measures for encouraging a larger flow of private investment to the less developed areas, we should review briefly the attitudes and concerns of the developing countries toward private foreign investment. In the first place, countries differ substantially with respect to the relative roles of private and public enterprise and to the role of the state in economic matters generally. It would be a mistake in our relations with developing countries to insist that they have the same economic structure as exists in the United States or Canada or Western Germany, although in some cases it may be appropriate to advise countries with respect to their laws relating to business enterprise when national policy issues are not at stake. We should accept the fact that in some countries railroads or electric power or even mining and petroleum and certain heavy industries, such as steel, may as a matter of policy be in the public sector of the economy or, if privately owned, be subject to regulations which go beyond those which exist in our own country. After all, we do have some publicly owned power and transportation facilities in the United States and many industries, such as agriculture and petroleum, are by no means free of governmental controls. Except in a few types of enterprises such as shipping, the United States does not discriminate against foreign enterprise, but again we cannot insist that every country adopt the same policies as we have in the United States or as generally exist in Western Europe. Over the years our own attitudes toward public ownership and regulations have changed as have those of other countries, and other countries are likely to resent attempts on the part of the industrialized countries to impose their own systems of business organization on

them, just as we would resent attempts on the part of other countries to change our legal and organizational structure of economic relationships.

Without necessarily depreciating the efforts of businessmen in the United States and abroad to formulate and obtain general acceptance of codes for the treatment of foreign investment, or the negotiation of bilateral or multilateral investment treaties, it must be recognized that for the reasons indicated above there are severe limitations on the use of such instruments for expanding the flow of private investment. This is not to say, of course, that efforts should not be continued to improve the climate for the flow of international capital by seeking formal agreements or understandings with governments for the avoidance of arbitrary and deliberately discriminatory actions which do not involve fundamental public policy issues, and for fair and prompt compensation in the event of expropriation of foreign property.

Despite the events in Cuba and the increasing Socialist sentiment in many of the less developed countries, there are growing indications in Latin America, and in India, Pakistan, and other Asian countries, of a desire to encourage foreign investment, and of an appreciation of its contributions to growth. Very often following the achievement of independence from colonial rule or following a left-wing revolution in a country which has been governed by a reactionary elite, or where foreign investors have wielded a large amount of economic and political power, the reaction has been to discourage and discriminate against foreign investment because it has become associated with the older political order. This was certainly the pattern in India as well as in a number of other countries immediately after they had won independence. However, after the revoluntionary fervor has died down and governments are faced with the serious business of developing their economies and making good on their promises to the people, they recognize the assistance that foreign private enterprise can provide, either in the private sector of their economies or perhaps in combination with government capital in the public sector. Although conditions in developing countries vary, we are witnessing the emergence of new attitudes on the part of the newly independent or nationalistic governments toward foreign private investment, and new patterns of relationships between foreign investors and the host countries.

Developing countries want to select the kinds of foreign investments that are made in their economies and they want to make sure that the activities of foreign enterprises are consistent with their national objectives. They do not want to see vast petroleum or mining or plantation empires created within their boundaries under the control of foreigners, and they want to see the benefits from the technical and managerial skills embodied in foreign investment diffused throughout their economies. They are also very much concerned about the balance-of-payments impact of foreign investments and want to make sure that, directly or indirectly, foreign investments make a contribution to their balance-of-payments position, either by providing substitutes for imports or additional foreign exchange from exports.

As a consequence of these and other attitudes, developing countries have adopted certain policies toward foreign enterprise which need to be taken into account by both private investors and governments

in the capital-exporting countries. First, foreign governments are tending more and more to "screen" investments and to limit foreign investments to certain fields or types of operations. Very often official approval of a foreign investment is necessary before a foreign investor is permitted to remit earnings or to repatriate capital at the official rates of exchange appropriate for this purpose. Second, developing countries tend to favor private investment in which there is a certain proportion of local capital participation, and many of them have laws regulating not only the proportion of foreign ownership of domestic concerns, but also regulations with respect to the proportion of local labor that must be employed. They favor the maximum use of local supervisory and managerial personnel, and many companies operating abroad have found it advantageous, not only from the standpoint of public relations within the host country, but also from the standpoint of costs and profitability, to train local managers and supervisors to take over the positions of foreign personnel as soon as possible. In this way the supply of managerial and technical talent in the developing country is increased and in time tends to become diffused throughout the economy. Joint ventures where control and ownership are shared with local enterprise serve to mobilize domestic sources of capital and increase entrepreneurial talent. Although to some extent the capital resources of a developing country are increased by foreign investment, the most important benefits undoubtedly come from the transmission of ideas, skills, and organizing ability. It is these elements rather than the fact of foreign ownership that less-developed countries are seeking.

A third aspect of this emerging pattern of foreign investment is especially significant in large enterprises such as petroleum and mining. Where such enterprises have not been nationalized, they are certainly regarded as quasi-public in nature, and the day has passed when a mining or petroleum firm can obtain a large concession covering thousands of square miles within which it can create an industrial empire with little or no interference with its internal or foreign operations. For example, in the field of petroleum investment, which is the most important single category of U.S. private investment in the less-developed countries, host governments are making it increasingly clear that they want to participate more fully in both the management and the profits of petroleum production and in the marketing of the product. The resolutions of the Organization of Petroleum Exporting Countries (OPEC) at their second conference in Caracas, Venezuela, in January 1961 clearly indicated the determination of the governments of petroleum-producing countries to exercise a larger degree of control over production, pricing, and marketing.[1]

These trends and attitudes of capital-importing countries do not necessarily mean a reduced role for foreign investment in their development programs. For example, in countries like Argentina and Mexico where the petroleum-producing industry has been nationalized, new forms of foreign private participation have been developed which reconcile the national interests of the host countries with the legitimate interests of foreign private enterprise. The number of U.S. firms employing joint ventures with foreign private enterprises is expand-

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[1] See text of resolutions adopted by second (Caracas) OPEC conference, Platt's Oilgram News Service, Special Supplement, Feb. 21, 1961, p. 1.

ing, and the long-cherished doctrine of 100-percent ownership and control of oversea investments is giving way to one in which a foreign firm, once established, will be transferred gradually to local investors and managers. Thus U.S. firms operating abroad might view their role more in terms of entrepreneurs seeking to mobilize domestic resources while using foreign capital and skills as catalysts, rather than as creators of large industrial empires over which they will maintain indefinite 100-percent ownership and control.

While we have been speaking principally of the attitudes of the poorer capital-importing countries of the world toward foreign investment, much the same applies to relatively rich countries such as Canada and Australia. Both of these countries have become increasingly concerned regarding the economic implications of vast aggregations of capital in their countries wholly owned and controlled from abroad. Although they are not asking U.S. and other foreign capital to go home, they are suggesting that both ownership and control, particularly of large firms such as General Motors-Holden, Ltd., of Australia, be shared with local enterprise.

In its efforts to promote the flow of private investment abroad, the U.S. Government should emphasize joint ventures and stimulate foreign investment activities of a large number of small- or medium-sized enterprises. A review of the loans to U.S. private enterprise abroad by the Development Loan Fund and the International Finance Corporation reveals that a large proportion of these loans have in fact gone to joint ventures. Firms given special incentives to go abroad in the form of loans and investment guaranties might well be encouraged by the U.S. Government to participate with local enterprise or to make available their securities to local investors. In the administration's new AID program, it is suggested that where substantial loan or guaranty support is provided by the U.S. Government in order to encourage private investment to go abroad, the U.S. Government should be able to participate in exceptionally high equity profits if they are earned. This problem might be dealt with in a manner similar to the practice of the International Finance Corporation in employing convertible debentures or profit-sharing securities in connection with loans or all-risk guaranties. The use of convertible debentures would provide a means by which the U.S. Government could sell shares in profitable U.S. enterprises abroad to investors in the host country. This would serve the purpose of increasing local private participation.

B. MEASURES FOR ENCOURAGING THE FLOW OF PRIVATE INVESTMENT TO LESS DEVELOPED AREAS

The reasons for the rather meager flow of U.S. foreign investment to the less-developed areas (other than to the extractive industries in certain countries) are not to be found simply in the political and commercial risks or in the general investment climate in these areas. Perhaps more basically, U.S. firms have not been attracted to these areas because of limited markets, and for the vast proportion of U.S. firms, the lack of familiarity with investment opportunities in these countries. Moreover, most firms have adequate outlets for their available capital in the United States and except for firms in the extractive industries which are generally on the lookout for raw materials that

they can sell in world markets, most U.S. firms require some special inducement to go abroad. By and large profits on foreign investments—with the possible exception of petroleum—have not been disproportionately high relative to rates of earnings in the United States. In a large number of instances manufacturing firms have gone abroad in order to preserve, or in some cases to expand, the market for their products, which they had already established by exporting from this country.

Although it is unlikely that we shall be able to find any one device which will "unlock the floodgates of American capital" for flowing into the poorer developing areas of the world, the importance of providing these countries with the unique benefits of private enterprise is sufficiently great to justify our experimenting with a number of inducements.

1. Tax incentives

More attention has been paid by the Congress and by various official and private investigating groups to the question of tax incentives as a means of promoting private investment in the less-developed countries than to any other type of inducement. Extensive hearings were held by the Subcommittee on Foreign Trade Policy of the House Ways and Means Committee under the chairmanship of Congressman Hale Boggs on this subject.[2] Proposals for tax inducements to foreign investment have ranged all the way from complete exemption of taxes from foreign-earned income to modest tax reductions from income earned on new investments in selected less-developed countries. Tax inducements fall into several categories, including: (*a*) reduction of the U.S. corporate tax (normally 52 percent) on income from foreign investments; (*b*) changes in the law with respect to the treatment of reinvested earnings of foreign branches and subsidiaries of U.S. corporations, and (*c*) accelerated depreciation for foreign investments generally or for investment in selected areas.

It is not the purpose of this study to review the many proposals for tax inducements or the problems associated with them. This field is an extremely complicated one and nearly all of the proposals that have been made have been subject to criticisms of one kind or another. The Treasury Department has been especially concerned that proposals may have the effect of reducing revenues or of encouraging foreign investments in areas where we have no special foreign policy interest in inducing investment, or of introducing inequities and loopholes into our tax system. We shall confine this discussion to the statement of a few principles in this general field and to a suggestion which has been made by Dr. Jack N. Behrman in a forthcoming book on "U.S. Private and Government Investment Abroad" (edited by Raymond F. Mikesell) to be published shortly by the University of Oregon Press.

First of all, we firmly believe that in view of the expressed attitudes of business regarding the importance of tax inducements and of the

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[2] See "Private Foreign Investment," hearings, House Committee on Ways and Means. Subcommittee on Foreign Trade Policy, December 1958; and "Foreign Investment Incentive Act," hearings on H.R. 5, House Committee on Ways and Means, July 1959. See also "Expanding Private Investment for Free World Economic Growth," a special report prepared for the Department of State under the direction of Ralph I. Strauss, Washington, D.C., April 1959. See also "Report to the President and to the Congress," Commission on Foreign Economic Policy, Washington, D.C., January 1954 and "Staff Papers," presented to the Commission on Foreign Economic Policy, Washington, D.C., February 1954.

conclusions of congressional, governmental, and private studies on this subject, tax inducements designed to increase the flow of U.S. private investment to selected oversea areas should be given a fair trial. It is important, of course, that in view of the cost of tax inducements to the Treasury, they should be made as selective as possible and should not, directly or indirectly, give special encouragement to investment in developed countries or open up tax loopholes to American citizens. In other words, tax inducements should be limited to the realization of our foreign policy objectives in specific situations. Also, they should be integrated closely with our general foreign aid programs for individual countries. Finally, tax inducements should take into account what we have learned about the motivations for foreign investments and the interests and attitudes of the host countries toward private foreign investment. In the light of these principles, we should like to outline very briefly the proposal made by Dr. Behrman mentioned above and, in addition, to endorse the proposal for legislation providing for a foreign business corporation (FBC) embodied in a bill (H.R. 5) which was introduced by Congressman Hale Boggs in 1959 and again, with certain amendments, in 1960.

Dr. Behrman has proposed that the Congress extend a partial exemption from U.S. taxes to all new foreign direct investments or licensing agreements (and management contracts) in countries whose economic development the U.S. Government desires to encourage. The investments would be limited to the types of projects which have the approval of both the foreign and the U.S. governments. The Agency for International Development (AID) would make available to the prospective investors tax exemption certificates which could be used for payment of tax liabilities equal to a certain percentage return on the foreign investment. The exemption certificates could be issued serially so that a given portion would be valid in each of a number of years. The exemption certificates need not be restricted to use against taxes on income from the particular project in which the investment was made. The project might be unprofitable so that no income would be earned, or losses might be incurred. In this case the certificates would be usable against any foreign income or possibly any income of the U.S. parent. Then, even if there were a loss overseas, the parent company investor would receive half of the anticipated income as a tax exemption on other income, thus reducing his risk. Of course, if the project were more profitable than expected, the exemption would still be given while all income above that exempted from taxation would be taxed at full rates. The exemption certificates would be accepted by the Internal Revenue Service which would have the information necessary to assure itself that the investment was actually made under the conditions agreed to between AID and the U.S. investor.

The Treasury Department is currently engaged in negotiating so-called tax-sparing treaties which provide for a reduction of the normal U.S. tax rates for a limited period equal to the amount of tax reduction granted by foreign governments to selected investments. In the absence of such tax-sparing arrangements, any reduction in foreign corporate income taxes would simply reduce the normal U.S. tax exemption by that amount. Although negotiations with certain countries have been going on over a period of several years, the fact that the treaties need to be ratified by both the U.S. Senate and by the foreign country has made the procedure so lengthy that at the time

of writing no tax-sparing treaties had gone into effect. It is believed that this procedure has proved to be too cumbersome and inflexible to be of any real value in inducing U.S. investment in developing countries.

2. *Investment guarantees*

The new AID program provides for an expansion of the system of investment guarantees to include certain additional political risks not now covered and, in addition, provides for the use of "all-risk guarantees" including insurance against loss of investment capital (as opposed to failure to realize profits) in certain circumstances where investments are extremely risky to private enterprise but are also quite important for realizing U.S. objectives in developing countries. The AID bill also provides for authority to issue all-risk guarantees on a share-the-loss basis. Thus, the U.S. Government and the investor would negotiate at the outset a percentage split of any gross loss to be assumed by each of them. Compensation to the investor would then be paid by the U.S. Government regardless of the cause of loss, but such compensation would be limited to an agreed percentage. Such arrangements entail, in effect, a kind of partnership between the Government and the private investor in selected investments in developing countries. This approach involving private-public partnership in our foreign aid programs is a highly desirable one; and together with more generous loans to U.S. private investors in order to enable them to undertake especially risky investments, it may provide the answer to the problem of mobilizing what is perhaps our greatest strength, private enterprise, for direct employment in our development assistance programs.

Just as we have tended to favor a move toward multilateral loan and grant assistance to developing countries, so also do we see considerable advantages in an international investment guarantee program. An international guarantee institution, perhaps organized as an affiliate of the World Bank, would help to mobilize private enterprise in all free world capital exporting countries for promoting economic development abroad. A proposal for such an institution is currently under study by the staff of the International Bank and has been endorsed in principle by spokesmen for the U.S. Government.[3] Eventually such an institution might supersede existing unilateral or bilateral guarantee systems under which individual capital exporting countries provide specific guarantees to their own citizens who invest abroad.

3. Government loans to U.S. enterprises operating abroad

Throughout much of the postwar period the Export-Import Bank has been making long-term loans to finance investments by U.S. firms operating abroad. Over the decade January 1, 1950, through December 31, 1959, roughly $380 million in Export-Import Bank loans were made to private firms in which U.S. companies or individuals had over 20 percent capital interest. However, the vast bulk of the loans made to U.S.-controlled firms are located in Latin America and most of them are either for the development of minerals (copper, sulfur, and iron ore) or for electric power (mainly subsidiaries of American & Foreign Power Co.). Recently the Export-Import Bank has been

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[3] See "International Development and Security," pt. 1, op. cit., p. 266.

making loans to U.S. private business firms abroad out of the local currency proceeds of Public Law 480 agricultural commodity sales; as of December 31, 1960, the dollar equivalent of such loans totaled $84 million. The DLF has also been making some loans to firms operating abroad in which U.S. capital has an interest. Except for promoting the development of raw materials abroad in which the United States has had a special interest, the United States has not made extensive use of Government loans in its economic development programs. Thus far even the activities of the International Finance Corporation, which was designed for this purpose, have been concentrated rather heavily in Latin America and have tended to be widely scattered with no particular relationship to the country's overall development program.

Ordinarily the Export-Import Bank or other U.S. external public lending agencies do not make loans covering more than 50 percent of the total foreign investment, and in most cases loans are limited to a considerably smaller proportion. Normal banking practice requires that a substantial proportion of an investment take the form of equity capital, whether the equity be provided by the foreign investor or by local interests. However, there are situations where our aid authorities are anxious to promote foreign investment not simply for the purpose of expanding opportunities for U.S. foreign investment generally or even for the broad purpose of encouraging a larger flow of U.S. investment into less developed areas, but more specifically for enlisting the services of U.S. private enterprise in carrying out a particular project of vital importance to a developing country. If the desired investment entails a high degree of risk, it may be necessary for the Government to provide a substantial proportion of the total capital for the project in the form of a loan to a U.S. private firm. Thus AID might lend up to 75 percent or more of the total value of the investment with only 25 percent of the equity coming from private sources. Such an arrangement in combination with guarantees would place the major burden of the risk on the U.S. Government, and, of course, by reducing the proportion of private equity funds, raise the potential profit anticipated on the equity portion of the investment. This approach to inducing U.S. private investors or possibly investors from other developed countries was suggested some years ago by the author in a study published by the National Planning Association.[4] It has recently been put forward by the administration as a means of providing special inducements to private enterprise in selected industries and areas.[5] The administration also proposes to follow the practice of the International Finance Corporation in using convertible debentures or profit-sharing securities in connection with loans to private enterprise in which the Government provides the bulk of the capital and, hence, assumes a very large proportion of the risk. Often such investments might result in very high profit rates on the equity investment, and the Government should be entitled to share in unusual profits as well as in the risks.[6]

A program of private-public partnership in the field of development assistance must involve not only a careful selection of projects

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[4] See Raymond F. Mikesell, "Promoting United States Private Investment Abroad," National Planning Association, Washington, D.C., October 1957, pp. 66–70.

[5] See "An Act for International Development, a Summary Presentation," June 1961, p. 108.

[6] Ibid., p. 108.

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for which the Government would be willing to give special inducements (as against the ordinary inducements through the regular guarantee and loan programs), but such projects must be closely related to the development plan of the host country. In addition, special efforts must be made for locating investment opportunities which will make a significant contribution to the developing countries. Frequently it is not enough for our missions abroad simply to locate such opportunities and then make the results available to the business community generally. In some cases "feasibility studies" of particular industries are undertaken by contract with private organizations that would not benefit directly from the results of such studies. Under the new AID program it is proposed that authority be granted to the Government "to enter into contracts with prospective investors pursuant to which the U.S. Government would pay up to 50 percent of the cost of feasibility surveys to be undertaken by such prospective investors. Each contract would provide that if the project to be surveyed was not undertaken by the investor, within a specified period of time from the date of the initiation of the survey, all information, findings, samples, and other materials developed in the course of the survey would become the property of the U.S. Government." At this point the Government could make the information and other materials available in whatever manner it considered appropriate. This is certainly an important advance over the previous method of investigating investment opportunities; and since it is more in line with investment procedures of private companies, it would serve to enhance the interest of a larger number of U.S. investors in going abroad, particularly in the less developed areas.

Only time and experience will determine the extent to which the various approaches provided for in the administration's new AID program will induce a larger flow of private investment. But the basic approach of enlisting private enterprise in partnership with the Government in achieving our foreign policy objectives is a desirable one. Mainly what is lacking in the administration's new kit of tools for the selective promotion of private investment abroad is an effective tax incentive program.

C. IMPACT OF U.S. PRIVATE FOREIGN INVESTMENT ON THE U.S. ECONOMY

Considerable concern has been expressed regarding the effects of U.S. private investments abroad on domestic producers of competing products, and more recently on the U.S. balance of payments.[7] This is an exceedingly broad and complex problem, especially when looked at from the standpoint of our investment flow to the developed and the underdeveloped countries alike. Moreover, it is not possible to make a complete separation between private investment in the developed and the underdeveloped areas since many European subsidiaries of U.S. corporations reinvest a portion of their earnings in

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[7] See, for example, "Foreign Investment Incentive Act of 1960," hearings before the Committee on Finance, U.S. Senate, 86th Cong., 2d sess., 1960, on H.R. 5; "Private Foreign Investment," hearings, Subcommittee on Foreign Trade Policy, House Committee on Ways and Means, December 1958; "Foreign Investment Incentive Act," hearings on H.R. 5, Committee on Ways and Means, July 1959; "The International Development and Security Act," hearings, House Committee on Foreign Affairs, 87th Cong., 1st sess., on H.R. 7372, pt. 2, June 1961, pp. 880 ff.; and "President's 1961 Tax Recommendations," hearings, House Committee on Ways and Means, 87th Cong., 1st sess., May and June 1961, pp. 27–40; 73–96; 260–272; and pp. 2587 ff.

affiliates in the less developed countries. Nevertheless, we shall seek to deal specifically with the impact of U.S. private investment in the developing countries under the assumption that the investment is made directly by firms located in the United States.

As was pointed out above, the bulk of our investment in the developing countries in the past has been in the extractive industries and this is particularly true for countries outside of Latin America. Although many of the minerals produced abroad are competitive with U.S. products, the United States is a net importer of most of them and will be increasingly so in the future. A portion of the petroleum, copper, lead, zinc, and other commodities produced by American enterprise operating in the developing countries is sold on world markets, mainly to Western Europe. From the standpoint of the overall foreign economic interest of the United States as well as from the standpoint of the economic and security interests of the free world generally, it would be a very short-sighted policy to deter, or even to fail to provide reasonable encouragement to, the flow of U.S. investment into the extractive industries in the developing countries. This is true even in times of temporary surpluses, since we know that the long-run demand for petroleum and for most minerals is bound to increase and it is necessary to carry on continual exploration and development of these basic resources if long-run supplies are to keep pace with demand. In addition, we never know when political developments, such as occurred in Cuba (which cut off our supply of nickel from that country), may reduce our ability to obtain supplies of petroleum or other minerals from certain areas. Thus from the standpoint of free world security interests, widely dispersed sources of supplies of fuels and of basic raw materials are quite important.

1. Effects on U.S. exports of manufactures to the developing countries

However, it is not in the field of raw materials production that special inducements to private capital are needed; it is mainly in manufactures and to some extent in the processing of raw materials produced in the less developed countries, both for local use and for export. As was pointed out in part II of this study, developing countries need to diversify their economies and to industrialize, both as a means of providing increased employment and output, and as a means of limiting their demand for imports in some areas in order to release foreign exchange for expanding their imports of capital goods and specialized commodities and services not yet produced domestically, and for making foreign investment and debt service payments. As countries develop, the pattern of their imports inevitably changes, but the total volume of their imports continues to rise and must indeed do so if a constant rate of economic progress is to be maintained. There are few, if any, examples of countries with free enterprise economies that have been able to maintain reasonable rates of growth over long periods of time while their imports have stagnated.

A substantial proportion of the direct private capital flow from the United States to both developed and underdeveloped areas takes the form of exports of capital equipment and other commodities and services from the United States. This is indicated by table 2 which shows transactions of U.S. direct investment enterprises abroad with

the United States. In fact, excluding transactions with U.S.-owned trading companies abroad, in 1957 total U.S. direct investment capital outflow from the United States was $2,482 million while U.S. exports of capital equipment and other goods to U.S. enterprises abroad totaled $2,629 million. In the case of U.S. manufacturing enterprises abroad, imports from the United States by these concerns totaled nearly 2½ times the value of capital outflow in 1957, and U.S. exports to U.S. manufacturing enterprises abroad also exceeded U.S. imports from these enterprises in 1957. (See table 2.)

Of course, U.S. firms investing abroad in less-developed countries are free to purchase capital equipment and other needed commodities from whatever source they choose; and where U.S. machinery and other goods are not competitive, they may buy in Britain, or Germany, or elsewhere. However, U.S. firms operating in an underdeveloped country are, by and large, more likely to make purchases in the United States than are German or other European firms which make investments in the same country. This is because U.S. firms are more familiar with American products, and in many cases the U.S. parent companies are producers of the equipment or components of products required by their affiliates abroad.

In the case of many developing countries with expanding markets, there is increasing competition among U.S. and other foreign firms for selling in these markets; and as these countries industrialize, products currently imported will sooner or later be produced in the developing countries themselves. Thus in many cases U.S. firms must produce abroad in order to maintain their markets in competition with the products of other countries. It is not simply a matter of the U.S. firm deliberately deciding to produce abroad at lower cost as against exporting the products of American labor.

In those cases where the U.S. AID authorities deem it desirable to provide special incentives for U.S. firms to invest abroad, either in the form of all-risk guarantees or by providing a large proportion of the capital in the loans, the Government is usually providing an opportunity for a type of investment which is of strategic importance to the developing economy. Of course, the U.S. Government could supply these commodities directly as a part of the AID program, but the purpose of a development assistance program is to enable a country to become self-sustaining. Moreover, it may represent a much more economical use of resources for the United States to encourage U.S. private investment to expand output of a particular commodity than for a local firm, or perhaps the foreign government itself, to undertake the job. In addition, our own economy is likely to benefit more from having a U.S. firm undertake to produce a particular product in a developing country than would be the case if it were produced by, say, a European enterprise. In any case, because of the low purchasing power of the developing countries, the choice is again not between exports and investment, even though foreign investment inevitably changes somewhat the pattern of our export trade.

2. Expansion of exports by the developing countries

Developing countries are having to turn increasingly to producing manufactures, not simply for their domestic requirements, but also for exports to world markets, including the United States. This again is an inevitable consequence of economic growth as countries move to

higher stages of development. They must broaden their export base, and if their exports of raw materials are not expanding fast enough to cover their import and other foreign exchange needs, they must turn to exports of manufactures. Because of low labor costs, many developing countries—particularly with the aid of advanced technology and skills from abroad—have made significant inroads on world markets for particular products, and we may expect this trend to continue in the future. Moreover, U.S. private enterprise operating abroad will hasten this process, and in doing so will make an important contribution to economic growth in the host countries by helping them to find additional sources of foreign exchange income to meet their growing needs. Unless their balance of payments problem is solved in this way, they will never achieve a condition of self-sustaining growth; economic progress will depend upon a continuing flow of financial assistance from the United States and other countries to meet their balance of payments deficits. Thus the long run objective of achieving a condition of self-generating growth in the developing countries is incompatible with efforts to limit their ability to sell manufactures on the world market. For example, countries like India with a large population pressing against limited land and natural resources must achieve economic salvation through a very substantial increase in exports of manufactures. In other words, India must turn more and more to the economic pattern of Japan.

We should not blind ourselves to the fact that this is going to retard the development of certain manufacturing industries in the United States that will be unable to compete with products produced at lower costs abroad, and in some cases firms in these industries will fail unless they turn to the production of other commodities. On the other hand, the demand on the part of the developing countries for the products of many other U.S. industries, particularly capital goods and high-technology products, as well as for our agricultural commodities, will continue to rise. While these structural adjustments are inevitable, with few exceptions their impact will not be so sharp as to cause an undue hardship. Moreover, firms producing for world markets in competition with certain rapidly growing industries in the less developed areas simply must look forward to making adjustments. In some cases the answer will be found in producing certain components or product lines abroad, while specializing in other components or product lines in the United States.

If the United States adopts a policy of shutting out imports of manufactures from developing countries or of discouraging the flow of U.S. capital to these countries for the production of commodities in which they may be competitive, we are indeed following contradictory policies. Unless we are willing to permit developing countries to trade, we must either give up, or greatly alter, our aims in the field of development aid. Trade and aid are not alternatives; they are closely related aspects of development assistance.

3. Impact on the U.S. balance of payments

Much of what has been said regarding the impact of U.S. private investment in developing countries on competition with U.S. products applies to the impact on our balance of payments. Assuming that our exports are reasonably competitive in world markets with the exports of other developed countries, there is no reason why increased production of manufactures and other competing products both for local

use and for world markets in the developing countries should affect our balance-of-payments position adversely. Developing countries will continue to spend the proceeds of their exports, or the foreign exchange savings realized from import substitution, for other imports from the developed countries. There remains, however, the question of the impact of the outflow of U.S. private capital itself upon our balance of payments. First of all, it should be said that U.S. dividend and other income receipts from foreign investments to all foreign areas have exceeded our net direct private capital outflow during every year except 1957 over the period 1950–60; and in the aggregate, total receipts have exceeded net direct investment outflow over the period 1950–60 by $8.5 billion. Moreover, the relationship between capital exports and investment income has been even more favorable in the case of the less developed countries largely because of the relatively high returns on U.S. petroleum investments abroad. It is true, of course, that U.S. purchases of the products of U.S. firms operating in the less developed countries have been substantial, but again, this is because such a large proportion of these investments are in the extractive industries and produce commodities of which the United States is a net importer. In fact, U.S. production of petroleum and other minerals abroad, which we do not produce in sufficient quantities to supply our own needs, actually improves our balance-of-payments position by improving our terms of trade since, without U.S. production abroad, import costs would be higher. Moreover, the United States reaps the benefits in the form of income receipts and sales of equipment and materials from U.S. operation of these productive facilities.

Table 3 shows the relationship between U.S. net receipts of income and direct capital outflow to the less developed countries for the years 1957, 1958, 1959, and 1960. It will be observed that total U.S. income receipts [8] exceed by a substantial margin net capital outflow to U.S. enterprises in these countries. However, U.S. direct capital outflow to Latin American manufacturing enterprises has tended to exceed income receipts from these enterprises. The earnings of these enterprises have exceeded the outflow of net capital from the United States but a substantial portion of these earnings are reinvested abroad.

Thus far at least the United States imports relatively small amounts of manufactures from developing countries; in addition, U.S. exports of commodities to these manufacturing enterprises abroad are frequently equal to, or in excess of, the actual capital outflow. It can, of course, be argued that sales of manufactured products in the less developed countries, which totaled over $2.7 billion in 1957 [9] (of which nearly $2.6 billion were local sales), displaced a considerable volume of U.S. exports. Although it is impossible to determine the extent to which production of U.S. firms abroad displaces U.S. or third country exports, it certainly cannot be assumed that in the absence of this production these poor countries would have imported an additional $2.5 billion or so from the United States. In the first place, substitution of domestic production for imports largely releases for-

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[8] Figures include reinvested branch profits, but not reinvested subsidiary profits. However, the subsidiary form is employed in most manufacturing investment abroad.

[9] See "U.S. Business Investments in Foreign Countries," U.S. Department of Commerce, 1960, table 22, p. 110.

eign exchange for other types of imports. Secondly, if U.S. enterprise had not produced these commodities, it is likely that a portion of them at least would have been produced either by local firms or by firms established by third countries.

In short, therefore, it is not possible to show that our foreign investments in the less developed countries have harmed our balance of payments, and on the whole they have probably improved our balance. Nevertheless, in the field of manufactures at least we may expect U.S. private investment abroad to have some adverse effects on the markets for certain U.S. products, both in the United States and in third markets. But since our capital outflow provides increased purchasing power for the developing countries and our investments abroad are paying good returns, private capital exports to the less developed countries will not in themselves impair our balance-of-payments position. For many years the developing countries as a whole are not likely to be substantial accumulators of gold and foreign exchange reserves. In the last analysis the impact on our balance of payments will be determined by the competitiveness of our exports in world markets, especially in relation to those of the relatively rich countries, and this will be the case whether or not we expand our investments to the developing countries. It might also be said that our private capital exports to the developing countries—other than those directed toward the extractive industries—are a minor element in our balance of payments in any case. And even if the special efforts of the administration would be successful in expanding this flow by as much as 50 percent, the amounts would not loom large in the total picture. Furthermore, to the extent that private investment, dollar for dollar, makes a greater contribution to economic development abroad, the total cost of our aid effort will be lower, as will also any impact upon our balance of payments.

TABLE 1.—*U.S. direct investments abroad by geographical areas, 1946, 1950, 1955, 1957, 1959, and 1960*

[Billions of dollars]

	1946	1950	1955	1957	1959	1960 [1]
World total	$7.2	$11.8	$19.3	$25.3	$29.8	$32.7
Canada	2.5	3.6	6.5	8.6	10.3	11.2
Europe [2]	1.0	1.7	3.0	4.2	5.3	6.6
Oceania, Japan, and Union of South Africa	.2	.4	.9	1.2	1.4	1.5
Total, high investment countries	3.7	5.7	10.4	14.0	17.0	19.3
Latin America [3]	3.0	4.6	6.4	8.1	8.9	9.3
Middle East [4]	.2	.7	1.0	1.1	1.2	1.2
Asia [5]	.2	.3	.5	.7	.8	.9
Africa [6]	.1	.15	.3	.4	.5	.6
Total, low investment countries	3.5	5.8	8.2	10.3	11.4	12.0
International [7]	([8])	.35	.6	1.0	1.4	1.4

[1] Preliminary.
[2] Includes Turkey.
[3] Includes 20 Latin American Republics and dependencies.
[4] Includes countries east of Suez up to and including Iran but excluding Turkey.
[5] Excluding Japan.
[6] All of Africa except Union of South Africa.
[7] Shipping enterprises registered in Liberia and Panama but operating worldwide.
[8] Not available.

Source: U.S. Department of Commerce, "Survey of Current Business," various issues.

TABLE 2.—*Transactions of U.S. direct-investment enterprises with the United States by area and industry, 1957*

[Millions of U.S. dollars]

Area and industry	Exports to United States	Capital flow from United States	Imports from United States		Remittances to United States	
			Capital equipment	Other [1]	Fees and royalties [2]	Income
Developed countries total	1,575	1,004	97	1,311	126	653
Canada	1,363	718	47	845	60	335
Europe	195	287	43	397	58	281
Oceania	17	−1	7	69	8	37
International (shipping)	[3] 120	108	21	9	6	14
Underdeveloped countries total	2,072	1,370	537	650	109	1,582
Latin American Republics	1,563	1,163	360	444	70	880
Western Hemisphere dependencies	114	57	43	10	2	31
Africa (excluding Union of South Africa)	104	9	9	82	6	41
Asia (excluding Japan)	291	141	125	114	31	630
Total	3,770	2,482	655	1,970	241	2,249
Manufacturing	1,093	432	94	1,112	117	429
Petroleum	1,441	1,408	409	756	56	1,276
Mining and smelting	898	199	82	57	11	210
Agriculture	327	[4]	5	6	1	65
Other	9	443	67	41	56	269

[1] Exports to and imports from the United States by trading companies are excluded.
[2] Excludes film rentals.
[3] Represents tanker revenues.
[4] Less than $500,000.

Source: Office of Business Economics, *U.S. Business Investments in Foreign Countries*, U.S. Department of Commerce (Washington 25, D.C., 1960), p. 146.

TABLE 3.—*U.S. net direct-investment capital outflow and net income receipts, by industry and selected area, 1957, 1958, 1959, and 1960*

[In millions of dollars]

Area	All industries		Petroleum		Mining and smelting		Manufacturing		Other	
	Net direct capital outflow	Net income receipts	Net direct capital outflow	Net income receipts	Net direct capital outflow	Net income receipts	Net direct capital outflow	Net income receipts	Net direct capital outflow	Net income receipts
Latin America, including Western Hemisphere dependencies:										
1957	1,220	911	867	578	137	119	99	62	117	152
1958	329	688	163	395	81	112	70	47	15	134
1959	389	671	158	313	92	187	66	51	73	120
1960 [1]	149	719	24	331	−60	235	125	64	60	89
Africa:										
1957	9	41	8	−25	1	37	3	15	−3	14
1958	38	8	13	−36	18	16	6	15	1	13
1959	48	7	23	−43	27	23	−1	13	−1	14
1960 [1]	81	−17	62	−90	14	41	−5	16	10	16
Asia, excluding Japan:										
1957	125	615	112	598	0	1	12	7	1	9
1958	106	734	86	704	1	0	6	11	13	19
1959	−13	694	−28	656	0	0	9	15	6	23
1960 [1]	−38	801	−57	759	2	1	7	19	10	22
Total, selected areas:										
1957	1,354	1,567	987	1,151	137	157	120	84	110	175
1958	473	1,430	262	1,063	100	128	82	73	29	166
1959	424	1,372	153	926	119	210	74	79	78	157
1960 [1]	192	1,503	29	1,000	−44	277	127	99	80	127

[1] Preliminary.

Source: "United States Business Investments in Foreign Countries," U.S. Department of Commerce, Washington, D.C., for 1957, 1958, and 1959 data; 1960 data from "Survey of Current Business," U.S. Department of Commerce, August 1961.

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PART IV

COMMODITY STABILIZATION POLICY AND THE LESS DEVELOPED COUNTRIES

(By Robert Loring Allen)

Instability in world markets for primary commodities causes sharp fluctuations in the exchange earnings of less developed countries. Recurrent disruption of import flows and balance-of-payments crises in less developed countries deter economic development and induce fluctuations in exports of industrial countries. Present policies are inadequate either to halt the fluctuations in exchange earnings or to prevent their harmful impact. In the following paragraphs we shall examine the record of instability and its causes, and consider policies and programs designed to reduce instability or modify its impact. Long-term commodity problems are studied in part V.

A. RECORD OF INSTABILITY

1. Instability of primary commodity trade

The average annual variation in the value of exports of primary producing countries in the postwar period has been about 12 percent. The Statistical Office of the United Nations and the International Monetary Fund have made elaborate studies which document fully the fluctuations in primary commodity trade. Since the turn of the century, the annual variations in export values have been greater for primary producing countries than for industrial countries. Between 1900 and 1913 average annual variation in the value of exports for the former was 9.7 percent and for the latter 7.7 percent. In the interwar period (1920–39) fluctuations for both increased. For export values of primary producing countries the annual variation was 18.1 percent and for industrial countries it was 14.0 percent. In the postwar period (1948–58) the value of exports of primary producing countries varied 13.3 percent annually, while that of industrial countries varied 10.8 percent annually.[1]

Rubber experienced the greatest value variation in the postwar period, 30 percent per year. Crude petroleum had the least variation, 4 percent per year. Grains had wide year-to-year changes, 15 percent per year for corn and wheat, 25 percent per year for barley. Nonstaple foods and beverages had smaller variations. Variations for

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[1] "World Economic Survey, 1958," United Nations, New York, 1959, pp. 39–53; "International Compensation for Fluctuations in Commodity Trade," United Nations, New York, 1961, 96 pages, and "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," International Monetary Fund Staff Papers, vol. VIII, No. 1, November 1960, pp. 1–76, are the three most recent valuable studies of commodity instability. The data cited in this section are derived primarily from them. Other studies include "National and International Measures for Full Employment," 1949; "Measures for International Economic Stability," 1951; "Instability in Export Markets of Underdeveloped Countries," 1952; and "Commodity Trade and Economic Development," 1954; "Annual Reviews of International Commodity Problems," all United Nations, New York.

metals were between 12 and 17 percent. Short-period fluctuations in export value are compounded of changes in both volume and price. The price component in many cases has been almost equal to the total variation. Thus, while variations in the postwar period in the value of trade were about 12 percent, prices fluctuated by about 11 percent and volumes fluctuated 8 percent. Rubber also experienced the greatest fluctuations in price, 25 percent per year. A few products demonstrated relative stability in price, including bananas, 2 percent per year; tobacco, 4 percent per year; and crude petroleum, 5 percent per year. Fibers, metals, and beverages had wide annual variations; 17 percent for wool, 18 percent for lead and zinc, and 19 percent for coffee. The grains and nonstaple foods had relatively less annual price change. Annual volume changes of 8 percent or more were experienced by only a few products, among them barley, wheat, beef and veal, silk, jute, tin, and lead. Sugar, bananas, tobacco, copper, zinc ores, tin concentrates, and crude petroleum had annual variations of less than 8 percent per year.

In the interwar period the average annual fluctuation in export values of primary commodities was 17 percent, or 40 percent greater than in the 1948–57 period. The interwar period was characterized by the recession in the early twenties, the depression of the 1930's, and the recession of 1937. No comparable setbacks have marred the postwar picture. The improvement in overall commodity trade stability in the postwar period, however, was not shared by all commodities. There has been relatively little change in variations in the export values of fibers and grains between the two periods. Beverages, nonstaple foods, nonferrous metals, and petroleum have experienced substantial gains in stability.

The average annual variation in the volume of exports in the interwar and postwar periods was about the same, 8 percent per year. Export volumes of some commodities, such as foodstuffs and textile fibers, were more stable in the postwar period and others, particularly the ores, metals, and nonstaple foods, were less stable. Even though price instability has declined somewhat in the postwar period, price changes still represent the major factor contributing to instability in the value of trade. Despite some improvement, prices and volumes of internationally traded primary products have not been stabilized nearly as much as have the economies of the major industrial countries in the postwar period.

2. Implications of the problem

The effects of instability are felt throughout the economies of less developed countries, are transmitted to industrial countries, and influence the financial stability of the international economy. Government policy in less developed countries, supported by compensatory public spending, can isolate the incomes of domestic exporters from variations in prices in world markets. For example, Burma's Government pays rice producers a fixed price and buys nearly all the domestic output, which is then exported at the world price. In some years the price may more than cover payments to producers. In other years the Government must pay, out of accumulated reserve or current budget, the difference between the domestic and world price. The achievement of domestic economic stability by less developed countries, however, implies that the demand for imports for consumption and investment remains the same even when export earnings decline.

When export prices fall, the Government may run a deficit and in order to maintain the domestic price for exports and simultaneously be subjected to balance-of-payments pressure as export earnings decline and imports remain undiminished.

In an effort to avoid serious balance-of-payment problems, primary producers have tended to maintain strict control over imports. Primary producing countries have endeavored to keep imports for consumption down, but with only limited success. Reduction of imports of fuels and industrial raw materials may cut the current output of the economy. The only major category left is capital goods. Thus, the principal impact of fluctuations in imports has been on the investment sector through cuts in capital goods imports.

If domestic incomes change with the volume and price of exports, then the incentive to invest in the private sector may be weakened and the demand for imported capital goods may decline. If, however, the Government maintains domestic incomes, the demand of the private sector remains unaffected. In addition, in most less developed countries public investment is a significant portion of total investment, and governments are reluctant to cut capital goods imports when doing so may impair their development program. Balance-of-payments difficulties may ensue if import demand is sustained, but development suffers if imports are reduced to match reductions in exchange earnings.[2]

Instability in exchange earnings, and hence in supplies of imported capital goods, makes it difficult to formulate and implement development programs in less developed countries. Investment activities are interrelated, so that a balanced growth of the economy may not be achieved unless various investment projects are completed in the appropriate time-phased fashion. Programing, of course, has elements of flexibility built into it so that some delays may be absorbed with relatively little harm. However, the fluctuations in exchange earnings experienced by many less developed countries are beyond their ability to absorb without harmful consequences for economic development.

The uncertainty introduced by instability affects private as well as public investment. Private investors are often disinclined to make longrun capital investments for fear they might not be completed or that costly delays may occur. Because of instability many private interests in less developed countries prefer short-term commercial investments to more basic investments in industry and agriculture. Instability may also interfere with important public services such as health, welfare, and educational programs. Since in many less developed countries governmental revenues depend heavily upon import and export taxes, instability may result in limiting important public functions.

There are also important consequences for industrial trading partners of countries whose export earnings are unstable. Instability impels less developed countries to maintain severe import controls and to substitute domestic production for imports whenever possible, even if domestic substitutes can only be produced at a very high cost relative to the cost of imports. Thus, instability acts in many instances

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[2] "The Quest for a Stabilization Policy in Primary Producing Countries: A Symposium," Kyklos, vol. XI, fasc. 2, 1958, pp. 139–265, and "Stabilization and Development of Primary Producing Countries: Symposium II," Kyklos, vol. XII, fasc. 3, 1959, pp. 269–401, examines in detail the internal policy problems of less developed countries.

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to reduce the sales of products of industrial countries. Less developed countries transmit fluctuations in their export earnings to industrial countries when a fall in earnings forces a contraction of imports. Less developed countries are important buyers of capital equipment, the demand for which is characteristically unstable in industrial countries. Even small changes in levels of output of equipment industries may be an important destabilizing influence in industrial countries.

Fluctuating prices and volumes of primary products moving into industrial countries also increase industrial production costs. Even though raw materials may represent only a small fraction of the cost of the final product, instability of raw material prices sometimes makes necessary price changes in the final product or the absorption of short-run profits and losses, thereby increasing risks. Thus, the costs associated with instability of primary commodities are borne both by the less developed and the industrial countries.

B. CAUSES OF COMMODITY INSTABILITY

The most important cause of instability of exchange earnings of the less developed countries is to be found in their heavy dependence upon a relatively few export products. Most of the less developed countries depend for 70 to 80 percent of export earnings upon two or three primary products. In some cases this dependence is as high as 90 percent or more as in the case of Chile's dependence on copper and nitrates and Colombia's dependence on coffee.[3] This dependence is not immutable and an important objective of economic development should be to broaden the export base as well as reduce relative dependence upon exports generally. Aside from this overall cause, we may identify three factors contributing to market instability of primary commodities; namely, (1) natural forces, (2) market structure, and (3) economic instability in industrial countries.

1. Natural causes

Weather and climate are the most easily identifiable natural factors. In one year a flood or drought may cut the harvest substantially and lead to a decline in volume. The next year a bumper crop, a result of plenty of rain and sunshine, can have a ruinous effect upon prices and export earnings. Plant diseases, storms, earthquakes, and other natural disasters also influence the market supply substantially.

Limited evidence suggests that instability resulting from natural causes is tending to decline. Insecticides and fungicides have been helpful in eliminating some crop diseases. Most crops are now produced in nearly every part of the world so that a natural disaster in the only producing area is no longer likely. Stocks are increasingly being employed for all products to offset fluctuations of this nature. Still, natural causes exercise a significant effect on volume and indirectly on price.

2. Market structure

Much of the instability in commodity trade is attributable to the world market structure of primary commodities. Both the supply and demand relationships to price tend to be highly inelastic in the short run. Consider the relation of price to quantity demanded for

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[3] The data can be found in issues of International Financial Statistics, and in International Trade, 1959, General Agreement on Tariffs and Trade, Geneva, 1960, appendix tables.

most primary products. It frequently matters little what the current price is; the same amount will be purchased regardless of price. Since the product is characteristically a small component of the total cost of the final product and is a technical requirement of production, a change in the price of the primary commodity will have little effect on demand. In other cases, the primary commodity may be a basic element in the level of living. Within limits, people buy wheat and rice in roughly the same quantities regardless of price. Under these circumstances a relatively small change in volume, perhaps resulting from bad weather, a strike, disease, or some other cause may have a substantial effect upon price.

In addition, the relationship of quantity supplied to the price of a primary commodity also tends to be inelastic in the short run. Once the crop is planted or the mine is in operation, the producer will make every effort to produce as much as he can, regardless of current price. The producer is interested in getting as much income as he possibly can out of existing capacity. A shift in demand, say from some speculative reason, against a supply which is unresponsive to price, may result in a large price change.

In the case of a number of primary commodities there is a considerable time lag between investment in new capacity and the output from that capacity. For example, it takes 5 or 6 years after planting for coffee and cocoa trees to begin yielding. The producers may start planting when prices are high, in the expectation that the price will remain the same. Seven years later the new capacity begins producing and total output may greatly exceed demand at the old price. The result is a sharp decline in price. The current low price for coffee is in part a result of an expansion of capacity undertaken in 1953 when the price of coffee was very high.

To take the analysis one step further, when producers find that their new capacity is not profitable, there is little or no new investment in new capacity and existing capacity is not properly maintained. Over time, supplies available on the market are reduced, but demand continues to rise, culminating in another period of high prices, and another period of excessive investment in new capacity.

Instability may also occur in the case of crops which are planted annually if producers, through faulty evaluation of the market, make current output decisions on the basis of last year's prices or the rate of change of prices. The producer may expand output this year if last year's price was high and curtail output this year if last year's output was low. This may set up an oscillation between price and volume which may continue indefinitely.

Inventories may act either as a stabilizing or a destabilizing influence in primary commodity markets, depending upon their level and the behavior of those who hold them. If there are stocks and there is either an upsurge in demand or a shortfall in current output, inventories may be sold and the price stabilized by changes in volume exported. Alternatively, if demand was temporarily depressed or good weather resulted in an unusually large output, stocks may be accumulated, thus maintaining price. In many cases the judicious employment of stocks has helped to stabilize primary commodity markets.

There are some drawbacks, however. It is expensive to maintain stocks and this cost ultimately becomes a part of the costs of produc-

tion. If stocks become large, the burden can become severe and not easily financed by less developed countries. Furthermore, stocks operate most effectively as a stabilizer when they are relatively small. If they become large in relation, say, to annual output, they tend to act as a depressant on price and a destabilizing influence on the market. With large stocks overhanging the market, prices have difficulty moving upward because at any moment inventories may be disgorged, possibly worsening the situation. If a holder of large stocks becomes discouraged, he may sell out at low prices in order to salvage something and in the process drive prices even lower.

3. Fluctuations in industrial countries

Business fluctuations in importing countries exercise a major influence on world markets for primary commodities. Assuming there is a 1-to-1 percentage relationship between domestic output and imports, a fall of 1 percent in domestic output in industrial countries represents a 1 percent cut in imports of primary products. Such a cut may be small to the industrial countries, but may be serious in terms of price or volume, or both, to less developed countries.

The situation is more serious than that depicted above, since industrial countries also produce domestically many of the primary commodities which they import. Assume that total requirements of a given commodity for the industrial countries at full employment is 100 of which 50 percent is imported and 50 percent is produced domestically. Then assume a recession in which total demand for the product declines from 100 to 75. If the cuts were distributed evenly between domestic and foreign producers as indicated above, exports decline by 25 percent. Institutional and business arrangements, however, as well as government protection of domestic industries, tend to favor domestic interests over foreign sources of supply. Hence imports of primary products may decrease by more than 25 percent.

The annual average change in domestic production of lead in the United States was 5 and 13 percent in the United Kingdom. The corresponding changes in import volume of this product were 26 and 22 percent. Many other products share this fate.[4] Even when domestic production is absent and imports are the sole source of supply, the impact of a decline in business on primary commodities trade is often exaggerated by the tendency of buyers in industrial countries to draw down inventories and halt purchasing.

Many circumstances and events, wholly unrelated to commodity markets, contribute to instability. Expectations about the economic and political future often weight heavily and in conjunction with other factors can upset the market. Fortuitous political events such as the Suez hostilities, the Berlin crisis, expected changes in governmental policies, and other events can move markets up or down, depending upon the nature of the event and how it is interpreted.

C. INTERNATIONAL COMMODITY AGREEMENTS AND ARRANGEMENTS

There are in general two approaches to the problem of instability of exchange earnings arising from fluctuations of the world markets for the primary commodity exports of less developed countries: (1) Meas-

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[4] "World Economic Survey, 1958," United Nations, New York, 1959, pp. 48–52, and table 16.

ures for stabilizing exchange earnings directly by means of compensatory loans or grants; and (2) measures for stabilizing the price of, or demand for, individual commodities by means of international commodity agreements. Dissatisfaction with the operation of international commodity agreements and the difficulties attending the negotiation of effective agreements for individual commodities, such as coffee, tin, rubber, and cocoa, have resulted in increased consideration being given to exchange insurance or compensatory schemes. However, before discussing compensatory agreements we shall deal briefly with existing and proposed international commodity agreements and other arrangements concerned with specific primary commodities.

1. Existing agreements

There are four major intergovernmental agreements in existence today: the International Coffee Agreement, the International Sugar Agreement, the International Wheat Agreement, and the International Tin Agreement. There are also, many study groups and conferences on individual commodity problems. In addition, there are a number of private cartels in primary commodity trade, such as De-Beers in diamonds.

A significant characteristic in the tin agreement is its buffer stock. When the price goes above an agreed level, the manager of the stock is authorized to sell; when it goes below an agreed level, he is authorized to buy. Thus, the buffer stock is designed to limit price movements between those levels. The agreement has been in operation since 1956 and has worked reasonably well. Some would argue that the reason for its generally satisfactory performance has been the restraint exercised by tin producers. The agreement contains export quota provisions which have been adhered to by the members.

At one point, in September 1958, the tin buffer stock broke down, because the manager was no longer able to buy tin. He ran out of funds. The Soviet Union, not a member of the agreement, was making large sales of tin. The dip was only temporary and the Soviet Union has subsequently agreed to participate in the tin agreement. The price recovery, however, must be attributed to a tightening of the quotas and European restrictions on imports of Soviet tin. More recently the price of tin has risen through the ceiling and the manager has run out of tin. The U.S. Government, although not a member of the agreement, sold tin from its stockpile to restrain the price increase. However, the United States was severely criticized for this action by some members of the tin agreement. Such criticism would seem to indicate that members are more interested in maintaining high prices than in stabilization.

The sugar agreement has had only limited success in avoiding wide price swings. Following its initiation in 1953 the price fluctuated above and below the agreement price until late 1956 when the price rose sharply and all quotas were removed. Even so, the price rise continued. When the agreement was renegotiated, the sugar council was empowered to buy and sell stocks to limit price changes. In mid-1961 sugar prices were again low, but the council could take no effective action. The United States nominally belongs to the sugar agrement, but in fact its sugar imports are determined under the Sugar Act which provides for country import quotas.

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The International Wheat Agreement is in principle a multilateral contract among a group of wheat exporting and importing countries. There are no restrictions on exports. Importing countries, however, agree to purchase certain amounts of wheat at a price above a stated minimum, and exporting countries agree to sell certain quantities at a price below a stated minimum. The successful operation of the agreement has depended heavily upon United States and Canadian policies. The U.S. domestic price and the international market price of wheat were both above the wheat agreement price range between 1949 and 1953. Beginning in 1953 the international market price declined and the wheat agreement price was increased so that while the U.S. domestic price has remained above the agreement price range, the world market price has been within the range and has been relatively stable.[5]

The coffee agreement of 1960 includes only producing countries in Latin America and Africa. It specifies export quotas and is designed to halt price declines by limitations on supply. Negotiations are underway to broaden the coffee agreement to include consuming as well as producing countries. The U.S. administration has indicated agreement in principle to such an arrangement.[6]

2. Evaluation of commodity agreements

International commodity agreements tend to suffer from a confusion of objectives, are difficult to negotiate, and frequently break down as a consequence. The usual rationale for such agreements is the elimination of short-term price fluctuations which, as has been indicated, serve no basic economic purpose and frequently result in a misallocation of resources and hardship on either producers or consumers. Ideally, commodity agreements should be designed to eliminate wide price fluctuations, while permitting price changes which reflect long-term or fundamental shifts in demand and supply conditions; they should not seek to stabilize or fix prices for long periods of time. Rather they should seek to prevent prices from changing by more than say 5 to 10 percent from the average level of prices, say over the previous 2 or 3 years. In practice, however, international commodity agreements have sought to maintain a more or less fixed floor on prices and, even where a serious attempt is made to avoid increases in prices above a certain level, the tendency is to seek an average level of prices above that dictated by long-term demand and supply conditions.

It may, of course, be argued that the objective of maintaining a "fair" price rather than one which seeks to iron out the peaks and the troughs, without interfering with long-run market forces, is a quite proper objective. Indeed, this is the objective of national agricultural price policies in many countries, including the United States. However, groups of countries which are parties to an international agreement, or even international organizations designed to administer international commodity agreements, lack the power over production and investment in new capacities that are available to national governments. Individual members of the agreements may observe export quotas for a time but continue to pile up stocks of coffee, cotton, or other commodities which hang over the market and constitute a con-

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[5] See International Financial Statistics, vol. 14, No. 7, July 1961, p. 20.
[6] "World Economic Survey, 1958," op. cit., pp. 112–130, for an examination of these agreements and an evaluation of commodity agreements in general.

tinual threat to the agreement price. Moreover, few, if any international commodity agreements include all producers, and the agreement price may simply represent an invitation to non-members to expand greatly their output and increase their share of the world market while, at the same time, benefiting from the relatively high agreement price.

International commodity agreements are, of course, strengthened by the inclusion of consuming countries that will agree to establish import quotas or assist the producing countries in policing their own export quotas. On the other hand, there are always some consuming countries that will refuse to join in an agreement. Moreover, the negotiation of an agreement which will satisfy the interests of both consuming and producing countries may involve serious conflicts and constitute sources of tension both in the negotiation of the agreement and its implementation.

There are many commodities which are produced both by the industrially advanced countries and by the less developed countries, but which are normally imported by the industrially advanced countries. These include agricultural commodities, such as grains and fibers, and minerals, such as lead and petroleum. Frequently, however, the industrially advanced countries adopt quotas or other restrictions on imports in order to provide protection for their domestic producers. There are also primary commodities such as cotton and wheat, which industrially advanced countries may be exporting in competition with the exports of less developed countries, and problems arise regarding export subsidies and other competitive practices. In these cases, special commodity agreements or informal arrangements may be desirable in order to eliminate conflicts over commercial policies and to assure growing markets for the products of the less developed countries.

3. Study groups and informal commodity arrangements

The problems of the type indicated in the previous paragraph are usually best dealt with, not by formal intergovernmental commodity agreements which seek to maintain prices through the establishment of export quotas or the use of buffer stocks, but rather by means of study groups and informal arangements and agreements of various kinds. There exist a number of committees and study groups which deal with particular commodities or commodity groups. There are also United Nations groups, such as the Commission on International Commodity Trade and the FAO Committee on commodity problems, which deal with a broad range of primary commodities traded in international markets. There exist study groups on lead and zinc, cocoa, citrus fruits, and copper; there is the International Cotton Advisory Committee, the International Olive Council, the International Rice Commission, the International Rubber Study Group, and the International Tea Committee, to name a few. These organs provide a ready forum in which problems of fluctuating prices and surpluses, commercial policy conflicts, and proposals for dealing with them can be discussed. Frequently informal or ad hoc accords are reached by these groups, but such agreements tend to be flexible and deal with short-term problems such as, for example, the application of temporary import quotas on particular commodities.

D. MEASURES FOR COMPENSATORY ACTION

The alternative to dealing with instability of exchange earnings of primary producing countries on a commodity-by-commodity basis is to compensate countries for sharp reductions in their exchange earnings where these reductions are traceable to decreases in the prices or export volumes of primary commodities. The International Monetary Fund is, of course, designed to assist countries in maintaining their imports in the face of temporary shortfalls in their exchange earnings. The IMF has permitted a number of foreign exchange drawings by member countries in order to deal with such emergencies. On the other hand, gross drawings from the Fund by primary producing countries have been only a fraction of the fluctuations in exchange earnings experienced by these countries, and there is a widespread view that the Fund is not designed to deal adequately with this problem.[7] For example, decreases in foreign exchange earnings as a consequence of a decline in primary commodity prices may turn out to be of long-term duration. In such cases a member country could not borrow continuously from the Fund, and may not be in a position to repay past drawings out of increased exchange earnings for a long period of time, if at all. Therefore, what may be needed is a kind of exchange insurance designed to compensate countries for reductions in their foreign exchange income resulting from the behavior of world demand for their major exports.

While a number of proposals have been made for compensatory action, the proposal currently receiving most attention is that put forward by a committee of experts appointed by the Secretary General of the United Nations entitled "International Compensation for Fluctuations in Commodity Trade" (1961).[8] The United Nations experts proposal constitutes a form of insurance to be administered by a Development Insurance Fund. Under the proposed scheme a country would be eligible for compensation in any year during which its export proceeds declined by more than a specified percentage of the average export earnings of that country over the previous 3 years.[9] Compensation would be 50 percent of the shortfall in foreign exchange earnings beyond the limit of allowable fluctuation.

Had the proposed U.N. scheme been in operation during the 1953–59 period, and assuming a 10-percent allowable fluctuation without compensation, the average annual benefits paid to primary product producers would have been $258 million, and all but $12 million of this amount would have been paid to low-income primary producing countries. If the allowable noncompensable fluctuation had been 2.5 percent, outpayments would have been $608 million, with $466 million going to low-income primary producing countries.

Resources for the proposed Development Insurance Fund would be contributed by all participants. Alternative means of determin-

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[7] "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," staff papers, op. cit., pp. 1–76, and "International Compensation for Fluctuations in Commodity Trade," op. cit., pp. 19–28.

[8] "International Compensation for Fluctuations in Commodity Trade," op. cit. The committee of experts consisted of I. H. Abdel-Rahman (UAR), Antonio Carrillo Flores (Mexico), Sir John G. Crawford (Australia), Albert Gailord Hart (United States), S. Posthuma (the Netherlands), M. L. Qureski (Pakistan).

[9] Export proceeds could be defined broadly as including all export earnings or more narrowly, as including only earnings from a list of specific primary products. The latter definition seems more desirable for a strictly compensation insurance plan.

ing the amount of individual country contributions have been suggested. For example, contributions might be based on per capita incomes of member countries or upon the volume of exports of primary commodities. However, it would be expected that industrial countries would bear the bulk of the financial burden of the losses incurred by the Insurance Fund while low income primary producers would be the principal net recipients.

For example, assuming a 5-percent noncompensable fluctuation in export proceeds and a 50-percent compensation of short-falls from the previous 3 years' average export earnings, compensation to the low-income primary countries would have averaged $383 million per year over the 1953–59 period; $85 million per year would have been paid to the industrial and high-income primary producing countries. With contributions based upon export proceeds, low-income primary producing countries would have paid $142 million per year, thereby deriving a net benefit of $241 million annually. On the other hand, industrial and high income primary producing countries would have paid in $326 million per year and sustained a net loss of $241 million.

Compensation could take the form of outright grants or of credits repayable when exports rose above the 3-year moving average. A loan scheme would have pronounced advantages over grants. Under a system of grants, a country could, by manipulating its stocks, conceivably generate a fluctuation from which it might benefit. In addition, since substantial repayments could be expected under a loan system, the net cost of the insurance scheme would be greatly reduced. However, under a loan plan a country experiencing a long downward trend in export proceeds might receive a substantial amount of compensation which would never be repaid, while a country whose export trade fluctuated would receive short-term assistance but no net compensation over a period of years.

If an insurance program based on loans had been initiated in 1953 and assuming a 5-percent noncompensable fluctuation and 50-percent compensation for short-falls from the previous 3-year average of export earnings, total loans would have been $2.7 billion and repayments about $1 billion with substantial additional repayments scheduled out of existing loans. Although an insurance fund of this kind would represent a net cost to industrial countries of the world, there would be important offsetting benefits. In addition to greater stability in the demand for their own exports, industrial countries would also gain from greater stability in prices paid for primary products and the avoidance of periodic shortages in the world supply of important commodities. In addition, the costs of promoting economic development in the backward countries of the world would be reduced. Finally, an adequate and well-functioning insurance scheme would reduce the demand for international commodity agreements and, in many cases, would encourage countries to improve efficiency and reduce costs of production of primary commodities, thus making for lower prices and a better allocation of world resources.

It should also be mentioned that an exchange insurance program modeled after the United Nations experts' plan was proposed for Latin America at the Punta del Este Conference in August 1961. In principle, the Latin American proposal is the same as the U.N. ex-

perts' plan outlined above except that the participants would be confined to the countries of Latin America and the United States.[10] Fluctuations in Latin American exports, however, are not confined to their exports to the United States. Nevertheless, the United States would be participating in a program which would compensate for total fluctuations in Latin American exports. Thus, a regional scheme, which includes only one major industrial country, would appear to raise serious difficulties as compared with one which included all or most of the countries of the free world.

E. PRIMARY COMMODITIES AND UNITED STATES AND WESTERN EUROPEAN COMMERCIAL POLICIES

The United States employs tariffs or quotas as a means of restricting imports of a number of primary products which are produced in the United States and, in the case of certain agricultural commodities, has adopted export subsidies for commodities exported in competition with the exports of primary producing countries. Protection to domestic producers or subsidies to exports are employed in the case of several agricultural commodities, including grains, cotton, wool, tobacco, and meats, and, in the case of minerals such as copper, lead, zinc, and petroleum. On the other hand, most primary products not produced domestically, including bananas, coffee, and cocoa, are on the free list. Although U.S. import restrictions and export subsidies undoubtedly reduce significantly the export markets of primary producing countries, it is almost impossible to quantify the effect of their elimination. For example, quotas on imports of minerals and petroleums reduce the quantity of exports to the United States, but they also maintain export prices at a somewhat higher level than would otherwise be the case. In the case of our export subsidies for certain agricultural products, their elimination might be accompanied by the removal of production and marketing controls in the United States with the result that, in the long run, U.S. exports of cotton and what might be larger and world prices lower than they are at the present time. In addition, U.S. noncommercial export programs, such as Public Law 480 sales, are highly advantageous to most developing countries that are recipients of such products, while at the same time minor damage may be done to foreign exporters of competing products. In citing these complications, however, we do not wish to give the impression that the elimination of tariffs and quotas on imports of primary products into the United States would not expand substantially the export earnings of other countries. For example, a recent study published by the National Planning Association has indicated that the elimination of U.S. import restrictions would result in increased sales of $850 million to $1.7 billion annually by Latin America alone.[11]

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[10] "Latin American Export Commodities: Market Problems," report of the group of experts on topic III of the agenda of the special meeting of the Inter-American Economic and Social Council, OAS Official Records, OEA/Ser. H/X.1, Pan American Union, Washington, August 1961, 46 pages.

[11] Louis O. Delwart, "The Future of Latin American Exports to the United States: 1965 and 1970," National Planning Association, Washington, 1960, p. 99, table 17.

West European tariffs and quotas are even more damaging to primary commodity trade. Nearly all agricultural products are subjected to quotas and tariffs. On some products including coffee, cocoa, and bananas, European countries levy excise tax for revenue purposes. In addition, some European countries give trade preferences to countries with which they have historical ties. The United Kingdom offers a preference in its markets to members of the Commonwealth, not all of whom are less developed countries. The African countries associated with the European Economic Community will also enjoy a preference in selling to the European Common Market. Now that the United Kingdom and other European countries propose to join the EEC, new preferences favoring certain primary producing countries may be established.

There has been a tendency on the part of the industrial countries to become increasingly self-sufficient in Temperate Zone primary products. Primary commodity production has increased in the industrial countries by about as much as in primary producing countries in the last 30 years, and over the same period the industrial countries have expanded food production by more than the nonindustrialized countries. While industrial countries have made substantial progress in reducing barriers to trade in manufactures, little progress has been made in reducing barriers on imports of primary goods from the less developed countries.

Policy recommendations

While the United States and Western Europe have become increasingly aware of the needs of the less developed countries for economic assistance, they have been less willing to undertake measures for broadening the export markets of the products of the less developed countries. In many ways the expansion of export markets is more important than technical and financial assistance, since without markets for their products, less developed countries cannot expect to achieve a condition of self-sustaining economic growth. While a fuller discussion of the commercial policies of industrialized countries is reserved for part V of this study, it is recommended that the United States and Western Europe, both unilaterally and through such organizations as the GATT and the OECD, adjust their domestic and external trade policies with respect to primary commodities so that the primary producing countries will enjoy a larger share in the growth of world demand for these commodities. In addition, no action should be taken by industrialized countries which will seriously impair the exports of primary producing countries.

In addition to the adoption of policies which will promote the longrun expansion of world markets for the commodities of primary producing countries, members of the OECD should cooperate with the primary producing countries in establishing an insurance fund along the lines recommended by the U.N. experts' report discussed above. In saying this, however, we do not imply that we are in agreement with every aspect of this proposal.

While we do not wish to take a doctrinaire position against all intergovernmental commodity agreements, we do not believe that they provide an adequate longrun solution to the problem of international commodity instability. On the other hand, we favor continued use of study groups in efforts to deal with problems relating to markets for specific primary commodities by means of flexible and informal arrangements. Finally, we view with alarm the tendency for European countries to establish regional preference areas which discriminate against less developed countries, including the Latin American countries, which are not associated with these regional groups. The United States, in cooperation with other OECD members, should work toward a general reduction of the barriers to imports of primary commodities from all developing countries on a nondiscriminatory basis.

PART V

COMMERCIAL POLICY AND THE LESS DEVELOPED COUNTRIES

(By Robert Loring Allen)

Part IV was concerned principally with the problem of instability of markets for primary product exports of the less developed countries. In the following paragraphs we will examine the longrun prospects for the exports of these countries and the implications of these prospects for their economic development, and for the commercial policies of the United States and Western Europe.

Exports of less developed countries are sensitive to the commercial policies of Western Europe and the United States. Since most of these exports are primary products which are processed and consumed in industrial countries, protective tariffs and quotas are a depressant on the level of exports of less developed countries. Even under the most favorable circumstances, exports of primary commodities are insufficient to pay for the imports required for an adequate rate of development in less developed countries. Industrial countries, however, also protect processing and manufacturing industries, thus dampening the program of industrialization by restricting the markets for the manufactured products of the less developed countries. The structure of tariffs and other trade barriers of industrial countries in effect constitute discrimination against less developed countries, since these barriers are scaled in a way which prevents less developed countries from processing and manufacturing for export. Economic development prospects of less developed countries are thus dependent upon changes in the commercial policies of the industrial countries.

A. STRUCTURE AND TRENDS OF TRADE

In 1960, exports of the less developed countries of the world were nearly $27 billion, representing not quite 25 percent of total world exports. Nearly three-fourths of the exports go to Western Europe, North America, and Oceania; these areas are also the origin of almost three-fourths of the imports into less developed countries. Nearly 90 percent of the exports of the less developed countries are primary commodities, and nearly two-thirds of their imports are manufactured goods.

About two-thirds of the exports of less developed countries consist of food and raw materials absorbed by the industrial countries. Nearly 20 percent of the raw materials and food exports of less developed countries are shipped to other less developed countries. The Soviet area imports 4 percent of the exports of less developed countries and other less developed countries import 23 percent. Food and raw materials account for 87 percent of the total exports of less developed

countries (29 percent for mineral fuels alone), and 13 percent of exports are manufactured goods (5 percent of which are base metals). Almost two-thirds of the imports into less developed countries consist of manufactured goods, nearly half in the form of machinery and transport equipment. About 58 percent of manufactures comes from industrial countries, 2 percent from the Soviet area, and 4 percent from other less developed countries. Of the one-third of the food and raw materials imports into less developed countries, 2 percent originates in the Soviet area, 18 percent in other less developed countries, and 16 percent in industrial countries.[1]

1. Trends in exports

Between 1928 and 1955–57 world manufacturing production rose 2½ times and world primary commodity production has doubled. The volume of world trade in primary commodities, however, has risen only 32 percent. If the exports of primary commodities from primary producing countries only are considered, the increase from 1928 to 1955–57 was 53 percent. Excluding petroleum exports, the exports of primary commodities from primary producing countries increased only 23 percent over the period. Exports of petroleum have increased nearly eight times. Some commodities barely increased at all. Exports of food, oils, and tobacco rose 7 percent and agricultural raw materials 5 percent between 1928 and 1955–57. Exports of beverage crops increased 38 percent, ores and nonferrous metals 79 percent, and fuels (except petroleum) 141 percent during the period.[2]

Examination of the period 1948 to 1955–57, and subsequently, does not alter this picture in any essential way. In this period primary commodity exports rose 39 percent for primary producing countries and 55 percent for the industrial countries. Excluding petroleum, the corresponding figures are 24 and 57 percent. This growth compares with a doubling of manufacturing exports and an increase of 58 percent in manufacturing production. Between 1948 and 1955–57, manufacturing production in less developed countries increased 51 percent and for industrial countries 59 percent.

Changes in prices since 1928 do not significantly alter the picture provided by volume data. Long-term aggregate price comparisons are misleading because of changes in the composition of trade. Moreover, improvements in the quality of manufactures are not reflected in the price data. Neglecting these statistical problems, however, the terms of trade between primary products and manufactures probably have moved in favor of primary commodities over the last 30 years. Between 1928 and 1955–57 they improved by 33 percent and between 1948 and 1955–57 by 10 percent. Since 1955–57, however, they have deteriorated so that in 1960 the terms of trade were probably lower than in 1948 and only about 20 percent higher than in 1928.

The purchasing power of the total exports of the countries whose principal exports are food and tobacco rose by 19 percent between

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[1] "World Economic Trends: Ways and Means of Promoting Wider Trade Cooperation Among States; Trade Relations Between Underdeveloped and Industrially Advanced Economies," E/3520, Economic and Social Council, United Nations, New York, June 7, 1961, 48 pages. See also "United Nations Monthly Bulletin of Statistics, March 1961, special table E and General Agreement on Tariffs and Trade," "International Trade, 1959," Geneva, 1960, appendix table 4.

[2] "World Economic Survey, 1958," United Nations, New York, 1959, table 1, p. 17. Much of the data in this section is based on ch. 1 of this survey, entitled "Trends and Fluctuations in World Trade of Primary Commodities," pp. 20–65.

1928 and 1955–57; for exporters of textile fibers, the figure is 50 percent; for rubber, 28 percent.[3] The exporters experiencing the greatest gain in purchasing power were the petroleum countries where the gain in purchasing power between 1928 and 1955–57 was nearly sixfold. On the other hand, for primary producing countries generally, the increase in purchasing power of exports was 53 percent during the period. Since 1957, however, primary product prices have declined and manufacturing prices have gone up. In the period 1950 to 1955–57 the purchasing power of exports of primary product exporters rose 8 percent (only 3 percent if petroleum exporters are excluded). For exporters of rubber, textile fibers, and food and tobacco, purchasing power neither improved nor deteriorated. Only metals and petroleum exporters experienced significant improvement in their purchasing power during the period.

2. Trends in imports

While the purchasing power of primary producing countries (excluding petroleum exporters) increased by 23 percent (1928 to 1955–57), the volume of imports for these countries increased by 92 percent. In every case except that of petroleum exporters, the rise in import volume exceeded the increase in the purchasing power of primary producing countries. Since 1950 the same trend also has been evident. Between 1950 and 1955–57 the purchasing power of primary producing countries (except petroleum exporters) has increased by only 3 percent but the volume of imports for the same countries has increased 23 percent. Even in the case of petroleum exporters the import volume has gone up more rapidly than has their purchasing power since 1950.

In 1928 primary producing countries experienced a $1.3 billion merchandise trade surplus. Each of the major groups of exporters had a favorable balance. Most of the surplus was attributable to exporters of metals and ores, rubber, and textile fibers. The total surplus represented 9 percent of exports. By 1955–57 the surplus had changed to a deficit of $1.6 billion. The $1.3 billion trade surplus for petroleum exporters was offset by a nearly equal deficit for textile fiber exporters, which had shown a substantial deficit even before 1950. Food and tobacco exporters had a $1.7 billion deficit, equal to more than 36 percent of their exports. Even in 1950 these exporters had a deficit of 16 percent of their exports. The 1950 surpluses for exporters of metals and ores and beverage crops had also turned to a deficit in 1955–57.

The increasing gap between imports and exports in the postwar period for less developed countries has been financed by liquidation of foreign exchange reserves, and by loans and grants from the industrial countries. The foreign public indebtedness of less developed countries has been increasing significantly in recent years. For example, at the end of 1955 the foreign public debt of less developed countries was $6.9 billion. Brazil was the most important debtor,

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[3] Purchasing power in this context is defined as the value of exports divided by the index of world export unit value for manufactures. Imports volume is defined as the value of imports divided by the index of world export unit value for manufactures. Food and tobacco exporters in this calculation are Argentina, Burma, British Guiana, Cuba, Dominican Republic, Ecuador, Greece, Israel, Jamaica, Mauritius, Morocco, Panama, Philippines, Spain, Thailand, Tunisia, and Turkey; textile fibers, Australia, Egypt, French Equatorial Africa, India, New Zealand, Nicaragua, Pakistan, Paraguay, Sudan, Union of South Africa, and Uruguay; rubber, Indonesia, Malaya, and Singapore. See "World Economic Survey," op. cit., table 18, p. 55.

with Argentina, Chile, Colombia, Peru, India, Israel, Central African Federation, the Congo, Indonesia, Iran each owing $200 million or more. By the end of 1958 this debt had increased to $11.1 billion, with Brazil ($1.5 billion), India ($1.4 billion), and Argentina ($1.4 billion) in the lead.[4] Since 1958 the external indebtedness of the less developed countries has risen substantially.

During the last three decades the trading position of less developed countries has deteriorated seriously. Exports have followed one trend line, a slowly growing one. Imports have followed another trend, increasing more rapidly than exports. Price movements have not offset volume changes. Less developed countries now face an annual trade deficit of significant proportions. Capital movements have until now permitted these countries to finance their growing import surpluses, but obviously the gap between the growth of exports and the expansion of imports cannot continue indefinitely.

B. FACTORS DETERMINING TRADE OF LESS DEVELOPED COUNTRIES

1. Growth of industrial countries

The rate of expansion of exports of primary products depends upon the rate of growth of the industrial countries, the principal consumers of these commodities. Stagnation in the industrial countries automatically implies serious problems for less developed countries. Strong growth implies relative prosperity for less developed countries. During the past two decades the industrial countries experienced a great war, as well as a minor war, during both of which the demand for primary commodities was high. The rapid postwar recovery and high growth rates in Western Europe and Japan as well as relative stability and progress in the United States have contributed significantly to sustained and expanding demand for primary products from less developed countries.

As incomes in industrial countries increase, the components of the consumer budget shift. At low levels of individual income most of the budget is spent on food and other basic living requirements. As income increases, new items enter the budget, such as consumer durables, luxury foods, services, and so on. The amount spent on primary commodities increases, but relatively these products lose ground. This relative shift in expenditures has been conspicuous during the past two decades as the United States and Many West European countries have become high-consumption economies.

Per capita consumption of food and tobacco declined slightly in the United States and Western Europe between 1927–29 and 1955–57. Per capita tobacco consumption increased 31 percent over the period, but per capita consumption of most foods declined. Wheat consumption, for example, in 1955–57 was only 64 percent of the 1927–29 per capita level. The same phenomenon can be observed with 1948–50 as the base. In the period between 1948–50 and 1955–57 per capita consumption of tobacco also declined. Beverage crops increased in per capita consumption between 1927–29 and 1955–57, but declined from 1948–50 to 1955–57.[5]

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[4] Avramovic, Dragoslav, and Ravi Gulhati, "Dept. Servicing Problems of Low Income Countries, 1956–58," Johns Hopkins Press, Baltimore, 1960, table II, page 13–14.

[5] "World Economic Survey, 1958," op. cit., table 3, p. 23.

An increase in the domestic output of a country will result in an increase in its demand for imports. If this calculation is put on a percentage basis, the result is an estimate of the income elasticity of demand; that is, the percentage increase in the demand for imports when income rises 1 percent. Most empirical evidence indicates that the income elasticity for all primary products for Western Europe and the United States is somewhere around unity; that is, an increase of 1 percent in income stimulates a 1-percent increase in imports. There is, of course, a different income elasticity for each product and over time elasticity changes. For foods and stable primary products it is probably lowest. For petroleum, on the other hand, it may be quite high. For example, per capita petroleum consumption increased 6 times for the United States and 13 times for Western Europe between 1927–29 and 1955–57.

2. Technological and industrial change

Technological change probably has a net detrimental effect upon the market for primary commodities. The record of the last few decades indicates that some less developed countries have been damaged by changes in technology. In general, the effect has been to economize on the use of raw materials so that at present a smaller input of raw materials is required to produce a given value of output compared with two decades ago.

More complicated and highly fabricated products are introduced as incomes rise and these new products contain a relatively smaller value of raw materials. The weight of metals in an automobile does not increase in the same proportion as its value, since more gadgets and refinements are being added. The attainment of higher degrees of precision in machinery and equipment makes them cost more but does not necessarily add to the value of the raw materials used. In addition, there have been a number of technological changes which have tended to economize raw materials. Electroplating of tin requires less raw material input per unit output. The lead content of the storage battery has been steadily declining. Greater precision permits less scrap wastage. Most of these changes have not been spectacular, but along with the higher degree of fabrication of products, have resulted in substantial economies in raw material inputs.

One of the most spectacular kinds of changes affecting raw material requirements has been the development of synthetic materials. Synthetic textile fabrics—rayon, nylon, orlon—along with shifting consumption patterns, have made deep inroads into cotton and wool trade. Between 1927–29 and 1955–57 the per capita consumption of textile fibers in the United States declined by one-fourth and in Western Europe by almost one-fifth. Wool, cotton, and jute have been particularly hard hit. Petrochemicals and plastics have begun to have an impact on raw material markets. Synthetic rubber has prevented any increase in per capita consumption of natural rubber in the last three decades.

In addition, technology has permitted the substitution of one primary commodity for another so that the fortunes of individual less developed countries are affected differentially as substitution takes place. Substitution takes place in response to changes in relative prices, as well as to changes in technology which make substitution

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feasible. If the price of copper is sufficiently high, aluminum will be used as an electrical conductor. Countries dependent upon the exports the demand for which has declined may suffer a substantial economic setback.

3. Government policies

Policies of less developed countries have a marked impact on the long-term prospects for primary commodity production and exports. Efforts to stabilize the value of exports may lead to unwise pricing policies which are harmful to exports. In attempting to restrict supply, some less developed countries may raise the price, discourage consumption, and possibly encourage the development of a substitute. It is probable that if tin exceeds its present level significantly, permanent substitution may take place. Improper domestic policies may inhibit economic development and maintain heavy dependence on primary products. In other cases, efforts to industrialize rapidly may result in neglect of important primary sectors and diversion of investment into uneconomical industries, thereby losing productive capacity capable of earning the foreign exchange required to finance sound development.

The policies of industrial countries also have a decisive impact on exports of primary products by less developed countries. By protecting and subsidizing domestic production of primary commodities they shrink the markets available to less developed countries and stimulate domestic production at higher costs. Over the postwar period the industrial countries have generally become more self-sufficient in primary products.

Even more important, from the point of view of long-run economic development, are the high barriers against processed and manufactured goods maintained by the industrial countries. In many cases these restrictions effectively prevent less developed countries from getting a start in manufacturing production and diversifying their exports.

C. TRADE AND DEVELOPMENT PROSPECTS

Over the past three decades the less-developed countries have been subjected to a steady deterioration in their trade position, moving from a position of a substantial surplus to a substantial deficit on the trade account, amounting to about $3 to $4 billion at the present time. The deficit is now covered by capital transfers. The question arises as to what is going to happen in the future. This question has been examined by the secretariats of the Economic Commission for Europe, the Economic Commission for Latin America, the General Agreement on Tariffs and Trade, and by a number of private research organizations. There are differences in the quantitative estimates but unanimity on the general character of the trends. If the less-developed countries develop economically at a rate consistent with economic and political stability, imports will continue to grow at a faster rate than exports and an ever-increasing trade deficit will be generated.[6]

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[6] "Economic Survey of Europe in 1960," Economic Commission for Europe, United Nations, Geneva, 1961, particularly ch. V, entitled "Europe and the Trade Needs of the Less Developed Countries," pp. V–1–50. The GATT study is reported in "Trends in International Trade," a report of a panel of experts, GATT, Geneva, October 1958, 138 pages.

1. Prospective import requirements

Leaving aside the constraint of the financing of imports, the rate of growth of imports is a function of the rate of population growth and the rate of growth of domestic product. Other facets, such as the rate of savings and capital formation, are involved but the simpler version provides a useful approximation. Using the best statistical evidence available the secretariat of the Economic Commission for Europe estimated that in 1980 the import demand of less-developed countries will be about $60 billion per year, if the latter are to achieve an increase in per capita growth of 3 percent per year. Using a slightly higher rate of growth (3.2 percent per year per capita) and a higher income elasticity of demand for imports (0.96 for GATT as opposed to 0.85 for ECE) the secretariat of the General Agreement on Tariffs and Trade estimated import requirements of $47 to $55 billion by 1969. Consideration of additional factors would improve this estimate somewhat but probably would not change the general order of magnitude.

Less developed countries during the 1950's had a per capita rate of growth of at most 1.8 percent per year, rather than the 3 or 3.2 percent per year assumed in these calculations. On the other hand, a per capita growth rate of 72 percent to 3 percent per year is generally regarded as an acceptable rate of growth for less-developed countries. The industrial countries over recent decades have grown faster than 3 percent per year per capita. Anything significantly less than this figure would imply a continued widening of the gap between per capita incomes in less-developed countries and those in the industrially advanced countries.

2. Future exports

If we accept the ECE secretariat estimates of imports required by the less developed countries for a per capita growth rate of 3 percent, the question becomes: How can imports of $60 billion per year in 1980 be financed? There are only three ways: (1) export proceeds from either primary commodities or manufactured goods, (2) net capital transfers from outside the less developed countries, and (3) liquidation of reserves. The last can be dismissed easily. The whole foreign exchange holdings of less developed countries in 1960 were less than $10 billion. Even this amount is probably too low in relation to imports.

In recent years capital transfers of all kinds into less developed countries have been about $3.5 billion per year. There is, unfortunately, no way to forecast what capital transfers will be in 1980 or, indeed, at any time in the future. Much depends upon the political and economic conditions at the time. The ECE secretariat assumed that net capital imports will increase in the same ratio as did imports and calculated a figure of $9.3 billion per year. There is, of course, no reason why any such relationship should exist and it is unlikely that industrial countries will provide net capital resources of that magnitude. Even accepting this optimistic estimate, one is left with about $50 billion to be financed in some way by exports.

We now turn to the question of export expansion. If $19 billion is taken as present exports (1957–59 average excluding petroleum exports). then to finance the entire residual by export proceeds would

imply an increase of 2½ times over the next two decades. Exports of these less-developed countries (excluding petroleum exporters) have increased only 23 percent during the past 30 years.

Western Europe, the United States, and Japan are the largest consumers, taking about $12 billion in traditional primary commodities from the less developed countries. Even on the basis of optimistic assumptions with respect to the markets in the industrial countries, it is improbable that exports of primary commodities could increase by more than 70 percent over the next 20 years. The rationale for this estimate is the rate of growth of the industrial countries and a favorable estimate of the ratio of imports of primary commodities to domestic product. Exports of primary products into the industrial countries will probably not exceed $20 billion per year in 1980.

Exports to the Soviet area are unpredictable. At the present time trade of the Soviet Union and Eastern Europe with less developed countries is somewhat in excess of $800 million each way. An optimistic estimate of 1980 exports of less developed countries to the Soviet area would be about $3 billion per year, assuming the Soviet area diminishes the degree of autarky and increases imports of food and beverage crops. There is no reason to believe that the Soviet Union will change its policy of autarky, however. Imports are used to supplement domestic resources but only when necessary and not on the basis of relative costs.[7]

Exports to other less developed countries represent less than one-fourth of total exports of those countries, less than $5 billion at present. Although trade among less developed countries has been increasing somewhat more rapidly than exports generally, an estimate of $10 to $12 billion per year for 1980 would be a highly optimistic one. This implies that such trade would increase almost twice as fast as commodity exports to the industrial countries.

The final accounting then, excluding trade in manufactures, would leave approximately $15 billion to be financed, nearly one-fourth of the entire import bill. The share of manufactures in total exports of less developed countries is now about 8 percent (not counting base metals). If manufactures are to make up the gap envisaged above, the proportion of manufactures to total exports in 1980 would have to be of the order of 30 to 35 percent. This would be difficult but not impossible. Other areas have done something like it. For example, machinery exports of seven industrial countries were 4 percent of exports in 1861–63, but jumped to 26 percent in 1911–13. For the U.S. machinery went from 6 to 36 percent and other manufactures from 10 to 26 percent during this period. Canada tripled the proportion of machinery and other manufacturing exports during the same period.[8]

The structure of trade of less developed countries in 1980, assuming the growth target is met, would be characterized by primary commodity exports of 65 to 70 percent and manufactures 30 to 35 percent. Exports to the Soviet area and other less developed countries would be expanding more rapidly than their trade generally. A net capital inflow of more than 15 percent of total imports would close the gap.

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[7] For a detailed discussion of Soviet foreign trade policy, see the author's "Soviet Economic Warfare," Public Affairs Press, Washington, 1960.

[8] "Economic Survey of Europe in 1960," op. cit., table 3, ch. 5, p. V–5.

These structural changes are possible only with substantial modifications of the policies of the industrial countries, not only with respect to primary commodities but also manufactured goods. Western Europe could absorb one-third of the new manufactures; the United States, Japan, and Oceania another third; and the less developed countries themselves, plus the Soviet area, the remaining third. New imported manufactures of $5 billion per year by 1980 into Western Europe would represent about 2 percent of the increase in domestic Western European demand for manufactures over the period. For the United States the proportion is even smaller.

No great reliance can be placed upon the above quantitative estimates. The ECE secretariat itself is the first to admit the limitations of data and the inadequacy of its projection techniques.[9] The model is too simple, operates at too high a level of aggregation, and omits many factors, such as technological change, which might make some difference in the results. Even so, the exercise provides a general frame of reference and indicates the order of magnitude of the problem. Neither primary commodity exports nor capital transfers will be adequate to finance the import bill of the economic growth of less developed countries. It is not a question of aid or trade. It is necessarily both; neither one alone is adequate.

D. IMPACT OF CHANGES IN COMMERCIAL POLICIES OF INDUSTRIAL COUNTRIES

1. Agricultural protection

A combination of domestic and commercial policies discourages imports through tariffs, quotas, and other restrictions, increases domestic production by price supports and deficiency payments, and encourages exports through subsidies. Protection is high for products which industrial countries also produce, primarily the temperate zone agricultural products. Imports of these products from less developed into industrial countries has declined substantially in recent decades. For example, in 1938 Western Europe and North America imported 11 percent of their wheat, corn, rice, butter, sugar, and meat from outside the area. In 1956 the net import figure was 4 percent and North America's net export position improved substantially during the period. The same is true of many basic agricultural raw materials.

Relatively small changes in domestic production in industrial countries can have a large impact on imports. For example, if in 1956 consumption of foodstuffs in the industrial countries had remained the same but production had been 1 percent lower and the deficit imported, the increase in net imports would have been almost 25 percent. If production had been 5 percent lower, North America and Western Europe would have been a food deficit area requiring net imports from primary producing countries. A moderate diminution of the degree of protection by the industrial countries might well have a significant impact on primary producing countries.[10] The principal beneficiaries of such a moderation in agricultural protection, however,

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[9] In conversations with the director of research and senior analysts at ECE the preliminary nature of the estimates was emphasized. The numerical figures were presented not as precise estimates but to provide an idea of the order of magnitude. The one certainty felt by ECE and others who have studied this problem is that imports adequate to support economic development, and exports, assuming present commercial policies will diverge increasingly during the next few decades.

[10] "Trends in International Trade," op. cit., pp. 80–102.

are frequently the high income primary producers, not the less developed countries. Some less developed countries, exporters of cotton, tobacco, and sugar, for example, would benefit directly from an easing of these restrictions.

The indirect benefits of an increase of the exports of even the high income primary producers are frequently overlooked. With larger exports these countries will import more, partly from industrial countries, but also partly from the less developed countries. Industrial and less developed countries alike, upon expansion of their exports, will import more from still other industrial and less developed countries. Thus, there will be a series of rounds of trade expansion, generated initially by the increase in exports of high income primary producing countries. The indirect effects eventually dwindle away, but not until they have lifted trade generally, including exports of less developed countries, to a higher plateau.

In addition to the tariffs an internal tax is levied on some agricultural products not produced domestically in Western Europe. For example, France has an import duty on coffee and tea as well as fiscal charges which are even higher. Tobacco and cocoa are usually subjected to very high fiscal charges. The purpose is to raise revenue. The effect is to reduce demand and exclude imports. An elimination of these duties and charges, which do not protect domestic interests, would permit a substantial expansion of consumption imports of these products. The lost revenue could be made up through general taxation.

The United States, through a price support mechanism, heavily subsidizes some of its agricultural sector. One result has been to accumulate such products as wheat and cotton on a large scale. These products are marketed at world prices but under favorable terms which represent a real concession to the buyer. There are at least three effects of such transactions. U.S. domestic production and exports are maintained at a level above that which would be justified by the market. Competing sellers of these products export less of these products because of U.S. behavior and some have complained bitterly. In many cases the competing exporters have been high income primary producing, rather than less developed countries. Less developed countries however, have benefited substantially through the favorable terms on which the products have been made available.

A general liberalization of trade restrictions by industrial countries in agricultural products would certainly result in some improvements for less developed countries. The incidence would be varied with some benefiting little, others a great deal. Gains would be experienced by high income primary producers, and indirect benefits would raise all exports, including those of less developed countries. Direct benefits to less developed countries from an elimination of nonprotective duties and internal charges would be substantial. Elimination of quota restrictions would also aid less developed countries significantly.

2. Mineral policies

The minerals industries of Western Europe are not adequate to satisfy their own consumption requirements. Even in the United States, which is generally well endowed in minerals, the domestic industry no longer suffices to meet the domestic requirements and the

gap between consumption and production is growing. Metal manufacturers are an important element in the exports of industrial countries and cost-raising trade restrictions are not welcomed by domestic producers in competition with foreign producers. For these and other reasons, such as the fear of rapid depletion of remaining resources, the industrial countries do not maintain extensive trade restrictions on many minerals.

The United States, however, has a tariff of 1.7 cents per pound of unmanufactured copper and in 1958 introduced quotas on lead and zinc. Previously, these two metals had been subsidized to some extent. The quotas are temporary and the present administration appears to be opposed to an extension of trade restrictions and is on record as favoring an internationally negotiated solution. Recently Congress enacted a 4-year subsidy program for lead and zinc designed to halt the contraction of domestic production. The effect of U.S. restrictions, whether quotas, tariffs, or domestic subsidies, is to cut down U.S. imports of these products. Petroleum is another exception to the generally liberal minerals policy of industrial countries. A "voluntary" U.S. quota was superseded by a mandatory quota in 1959. Without doubt the oil quota diminishes the volume of U.S. imports. One authority estimated that if the quota were abandoned the increased imports from Latin America alone would be $500 million to $1 billion.[11]

3. Impact of reducing barriers

The elimination of restrictions on trade in primary commodities would probably result in a significant increase in the exports of less developed to industrial countries. The market share of less developed countries would increase for a considerable period of time. Eventually, the basic primary product export trend, determined by the nature of demand, would reassert itself. The level of exports of less developed countries in the meantime would have been raised substantially above the present level.

The estimates of demand of the industrial countries given earlier have taken into account some liberalization of commodity trade restrictions. An increase of 70 percent in exports from less developed to industrial countries over the next years is not consistent with the present level of restrictions. An elimination of restrictions, however, would probably permit an even greater expansion of exports of less developed countries and would help to reduce the potential deficit faced by these countries 20 years from now.

4. Protection of raw material processing

One important area of manufacturing into which less developd countries might expand is the further processing of their own primary commodities and exporting the processed goods. Industrial countries maintain substantial barriers against these goods at the present time. For example, many European countries do not have any barriers against cocoa beans and those countries which do—West Germany, Austria, Sweden, and the United Kingdom—have duties of less than 10 percent. On the other hand, there are much higher barriers against cocoa powder, paste, and butter. West Germany's tariff on processed

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[11] Louis O. Delwart, "The Future Latin American Exports to the United States: 1965 and 1970"; National Planning Association, Washington, 1960, p. 99, table 17.

cocoa is over 30 percent ad valorem, France and Italy both about 25 percent (with no tariff on cocoa). The average duty for the European Economic Community is about 28 percent on processed cocoa, but an average of only 9 percent on cocoa beans. The same kind of differential exists for such items as oil seeds, nuts, and kernels (processed vegetable oils), natural rubber (fabricated materials), hides and skins (leather), logs (timber), raw cotton (yarn and thread), and many other raw and fabricated products.[12]

There are great potential gains to less developed countries from processing their own materials. More value is added in the country and hence, exports command a higher price, adding to foreign exchange earnings. There are, however, added costs in processing. High capital and other costs, locational factors, and inability to use byproducts sometimes limit the extent to which less developed countries can advantageously process raw materials.

The demand prospects for processed materials are only slightly better than the demand for raw materials. Exports of processed materials tend to follow the same trend as primary commodities, after the once-and-for-all upward adjustment had been accomplished. As in the case of agricultural and commodity specialization, industrialization concentrated solely in these lines would not close the prospective exchange gap. Even so, the important capacity of less developed countries would probably be enhanced by between 10 and 20 percent if they processed their own materials.

5. Protection of manufactured goods

Western Europe and the United States impose high tariffs on manufactures and some countries employ quotas. In most cases the restrictions are sufficiently high that goods from less developed countries are excluded. In textiles, where some less developed countries have made significant headway, quotas and voluntary agreements limit exports to industrial countries. The United Kingdom has negotiated agreements which limit the access of Indian, Pakistani, and Hong Kong textiles to the British market. The new standstill textile agreement is designed to promote textile exports of less developed countries, but within the framework of an international quota system.

A reduction or elimination of trade barriers against manufactured goods from less developed countries would substantially assist these countries in covering their prospective trade deficit. The amounts of manufactured goods involved are small in relation to the manufactured goods of the industrial countries, but relatively large compared with present manufacturing production in the less developed countries. Except in a few lines, the impact on industrial countries of an elimination of trade barriers against manufactures probably would not be significant for several years. At the present time most less developed countries are not in a position to manufacture and export products to industrial countries on a large scale. Indeed, their development programs have been moving in the opposite direction, toward the displacement of manufactured goods in domestic markets from industrial countries to local producers. Time would be required to build the plants and establish the marketing outlets for new manufacturing production. It would also take time for the less developed countries to become convinced that such a change in plans was warranted by policy changes

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[12] "Economic Commission for Europe in 1960," op. cit., ch. V, chart I.

in industrial countries. Much also would depend upon the method of reducing tariffs. If trade barriers were reduced on a nondiscriminatory basis, it is possible that industrial countries for a long period of time could capture the newly opened markets.

The near-term impact would probably be in textiles in which some less developed countries have already begun to establish themselves. Canned goods, leather, and rubber products are other items which less developed countries might export. Concentration in activities in which the labor-output ratio was high and the capital-output was low would be advantageous for most less developed countries. This would simultaneously make use of their relatively abundant factor—labor—and economize on the use of foreign exchange for capital goods. Locational and other cost factors inhibit less developed countries in some lines of production. The possibilities are not unlimited in manufacturing production but by the time less developed countries are established in some lines, external economies, and a broadening of the industrial base will permit other manufacturing production.

Diversification and economic development, accompanied by increasing manufactured goods exports to industrial countries and other less developed countries, are feasible and promising approaches to some of the most pressing problems facing less developed countries. In order to achieve such a solution, however, significant changes in the economic structure of both groups of countries will be required.

E. EUROPEAN PREFERENCE SYSTEMS

A number of less developed countries have special trading relationships with one of the European powers. The countries comprising the British Commonwealth of Nations and the French Community grant preferential tariff treatment to one another and, except for a few British quotas, do not maintain quantitative trade restrictions. All goods originating in the French Community are admitted duty free into France, a preference of substantial consequence since the French tariff is high. The Community, however, does not necessarily reciprocate and in some cases these countries do not provide any preference for imported French goods. The United Kingdom grants a tariff preference in its market to Commonwealth countries, but goods do not enter duty free. Commonwealth countries do not necessarily provide a reciprocal preference for British goods entering their markets. Ghana, Kenya, Nigeria, Tanganyika, and Uganda, for example, give no preference to British goods. Hong Kong and Singapore give preferences on tobacco and some beverages.

Trade concessions by France to the French Community are being extended to the European Economic Community (EEC) so that those less developed African countries associated with the EEC will enjoy a preference throughout much of industrial Europe. The relationship between the Commonwealth and the EEC is unclear since the United Kingdom applied for admission into the EEC only in October 1961. It is probable, however, that the new enlarged EEC will make some trade concessions to Commonwealth countries. Thus, under an expanded EEC, nearly all European industrial countries will probably discriminate against the products of some less developed countries in favor of the exports of others.

The less developed countries within the preference system will benefit substantially since their primary products will enter European markets either free of duty or with a margin of preference. Trade will be diverted from countries outside the preference system to those inside the system. It is probable that the greatest impact will be felt by Latin American and some Asian countries.

On the other hand, all less developed countries will benefit if the European Economic Community contributes to the economic growth of the industrial countries of Europe. As the European economies expand more rapidly, their trade will also expand, providing larger markets to all less developed countries. The larger share of the benefits, however, will go to the countries enjoying a preference in the European market.

There is no economic justification for a preference system which discriminates against some less developed countries and favors others. The roots of the present and prospective preference arrangement are in the colonial relationships which have now ceased to exit. It cannot be established unequivocally that less developed countries as a whole will benefit from a European preference system, and it can be established that some less developed countries are damaged. Either a completely nondiscriminatory policy or a preference system for all less developed countries would have more merit than partial discrimination.

F. POLICY RECOMMENDATIONS

The United States and other industrialized countries should regard policies which affect the export markets of the less developed countries as being equally, if not more, important to the economic development and welfare of these countries as the provision of financial and technical assistance. The American public and its representatives must be made aware of the fact that, unless steps are taken to permit a broadening of world markets for the products of less developed countries, much of our foreign aid will be wasted in the sense that these countries will never achieve the objective of self-sustaining growth.

Our fundamental recommendation is that the United States in cooperation with other advanced countries should take immediate steps to increase the share of the products of the less developed countries in the world markets for primary commodities. This means gradually reducing import restrictions, including revenue tariffs, on primary commodity imports from the less developed countries, and forgoing export policies which may reduce the markets of these countries in order to favor domestic producers. No member of the OECD, including the United States, should take actions which affect the world market for primary products without full consultation through regularly constituted international committees on which the less developed countries concerned have adequate representation. Moreover, where special restrictive action may be regarded as necessary, the burden of reducing supplies available for the domestic market should be shared equitably between domestic and foreign producers. Thus for example, if a reduction in the total supplies is required in order to maintain the domestic price of an agricultural commodity or a mineral, the share of the domestic market enjoyed by primary commodity producing countries, and particularly those with low incomes,

should not be reduced. Moreover, any quantitative restrictions on imports of primary commodities from less developed countries should be temporary in nature, and all tariffs on primary commodity imports should be gradually abolished.

The abolition of tariffs and other restrictions on primary commodity imports, in which advanced countries compete with less developed countries, will undoubtedly require cooperative action through the OECD and the GATT. This should constitute an important part of a program for general tariff reduction on the part of the OECD countries. However, in order to speed the impact of such reductions on the exports of the less developed countries, it may be desirable to grant special concessions to these countries, which are not made available to the advanced countries which may be exporting in competition with less developed countries. This means, in effect, a modification of the "most favored nation principle" with respect to imports. In order to avoid conflicts over discriminatory actions, special concessions to the less developed countries should be negotiated multilaterally through the GATT or, if arranged bilaterally, such arrangements should be made as a consequence of agreements among the OECD countries. In addition, the industrial countries should not insist upon reciprocal trade concessions from less developed countries.

It is especially important to avoid arrangements which result in discrimination in favor of one group of less developed countries as against another. An immediate problem in this field has arisen as a consequence of the EEC and the possible inclusion of the British Commonwealth countries in a European preference system. The United States should work through the OECD to negotiate arrangements which will avoid or gradually reduce such discrimination.

In the longer run, measures to expand world markets of less developed countries for industrial commodities may be equally or even more important than those designed to increase their markets for primary goods. As we have seen, less developed countries must broaden their export base by exporting semiprocessed and finished manufactures. This problem is so urgent that it cannot wait for the gradual reduction of tariffs and other barriers to imports on a "most favored nation" basis principle. Frequently the commodities which less developed countries are most capable of producing for world markets are the very ones on which the heaviest burden of import restrictions has been imposed by the more advanced countries. Although it is too much to expect that the more advanced countries would abolish immediately their tariffs and other restrictions on textiles and other manufactures from the less developed countries, they might very well establish low, or even duty-free, quotas on manufactured goods from less developed countries. Again, measures of this type involve discrimination, and for this reason they should be the subject of multilateral agreement through the GATT or perhaps the OECD.

1. Need for a trade adjustment program

The measures and policies recommended above will not have a serious overall impact on the economies of the United States and Western Europe. On the other hand, some industries and regions may be seriously affected and it may be necessary to adjust domestic agricultural programs in a manner which would reduce domestic out-

put and prices for some products. These may be regarded as short-run costs to the economy made necessary by our concern for economic progress of the less developed countries. It should be said, however, that unlike foreign aid, adjustments to increased imports do not constitute a resource loss for the economy but rather make possible, in the longer run, increased welfare through lower prices to the consumer and a better allocation of our total resources for maximum output value. Nevertheless, increased imports may very well represent real loss or hardship for individuals and communities, even though the loss may be balanced by gains elsewhere in the economy. For this reason, a national trade adjustment program is not only desirable from the standpoint of equity, but is to be favored as a means of increasing support and understanding of the need for commercial policies which will promote the welfare and growth of the poorer countries of the world.[13]

The implementation of an adjustment approach to import liberalization is a very complicated one. As anyone acquainted with the activities of the U.S. Tariff Commission is well aware, it is frequently difficult to determine the extent of injury (if any) to an industry resulting from increased imports. Nevertheless, since the law requires that tariffs or other restrictions on imports be imposed wherever a case of serious injury to domestic industry is proved, it should not be too difficult to go a step further and provide other forms of relief for such injury, and more importantly, measures for speeding the adjustment of our economy to increased imports.

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[13] For a discussion of the mechanics of the adjustment approach, see "The United States and World Trade," final report of the Committee on Interstate and Foreign Commerce, U.S. Senate, June 26, 1961, pp. 155 ff.

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