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NEW PROPOSALS FOR THE INTERNATIONAL FINANCE OF DEVELOPMENT

Recent discussions on the external flow of capital to developing countries have clarified two major issues. The first relates to the strategic importance of external finance in the process of development. Capital inflow serves the function not only of augmenting the resources available from domestic savings, but also of solving the problem of strategic scarcities in imported goods and services. While the inflow necessarily bridges the savings gap and the import gap by one stroke in *ex post* accounting, the degree of difficulty in closing the two gaps *ex ante* in the context of planning may be very different. In many cases, the import gap is more stubborn or less manageable than the savings gap. Goods and services—such as machinery and equipment, skilled labor, and management—needed for development may have to be imported, because the domestic supply is severely limited; nor can they be easily augmented by transforming domestic resources into exports or import substitutes, owing to market limitations and structural rigidities. Under such circumstances, an increase in domestic savings alone, which may conceivably be brought about by appropriate domestic policies, may not be sufficient to meet the requirements of development.

The second issue relates to the absorptive capacity of the developing countries for external finance. Although this capacity is difficult to measure, there is evidence gathered by experienced country specialists and area economists, notably those of the International Bank for Reconstruction and Development, that an increase of several billion dollars in external finance is well within their absorptive capacity. This is hardly surprising when it is recognized that the absorptive capacity may in turn be a function of external finance, through, for instance, technical assistance, which results in more effective utilization of resources. Furthermore, it is also consistent with conclusions drawn from studies on the contribution to economic development by foreign aid in a number of countries. Indeed, the estimate of several billion more dollars is to be interpreted as a very rough indication of a minimum range rather than a limit.

Yet, despite the clear recognition of the strategic importance of external finance in the developing countries and the ability of these countries to absorb it, the response of the developed countries in providing

finance is not encouraging. It is true that virtually every developed country has, by now, an "aid" program. Furthermore, such aid has increasingly been viewed by many donors as an instrument of development rather than a means of securing commercial or military advantage. Nevertheless, the fact remains that the flow of financial resources to developing countries has increased little during the nineteen sixties, and there is as yet no clear indication of any dramatic increase in the near future.

The purpose of this essay is to examine the underlying reasons for this impasse and to suggest new initiatives in bringing about a significant increase in the flow of development finance. The accent is on the increment, which is getting more and more difficult to obtain without opening a new front of attack. Admittedly, the discussion is dated, in the sense that it starts from the existing circumstances in the present historical juncture. Should there be a drastic change in these circumstances, such as a shift in the priorities of national governments from domestic goals to world development—a massive release of resources for peaceful development through universal disarmament, or the conferring of tax power on international organizations—some of the new initiatives may appear to be no more than "second best." But, when ideal solutions are not within reach, a less than ideal but more practical solution is needed to break the current impasse.

FUNDAMENTAL WEAKNESSES IN CURRENT INTERNATIONAL EFFORTS TO INCREASE DEVELOPMENT FINANCE

There has been, of course, no lack of efforts to increase the flow of international finance for development in recent years. International discussions have, in fact, been so clearly and loudly dominated by the voices of confrontation between the North and the South that there has hardly been a single occasion on which the need for the developed countries (the North) to assist the developing countries (the South) has not been stressed. In a broad sense, efforts for the restructuring of trade relations between the developed and the developing countries are aimed fundamentally at increasing the flow of development finance. Indeed, foreign exchange earned through an expansion of trade, or "earned finance," may be preferred on many counts to "aid finance," or unilateral transfers, if for no other reason than to create a sense of self-reliance. More important, however, is the fact that many recent trade proposals actually involve an element of aid comparable to a direct financial transfer. Thus, additional export proceeds resulting from an international commodity arrangement, which raises the price in question to a higher level than would otherwise prevail in the market, should properly be considered as an implicit financial transfer, although they are not gen-

erally treated as such in conventional international reporting. At the same time, efforts toward increasing the quantity and improving the quality of aid finance, in the usual sense of direct transfers, bilaterally or through multilateral institutions, have also been conspicuous in current international discussions.

The fact remains, however, that progress either on the trade front or on the aid front has been slow at best. The main reason for this slowness stems evidently from a lack of international solidarity in a world of sovereign nations; but it does not follow that the approach should be limited to an educational crusade extolling the virtues of the brotherhood of man—a task which has been undertaken by many religious groups throughout history. When the preaching emanates from the developing countries in the North-South confrontation and degenerates into a scorching criticism of the sins of the adversaries, its effectiveness is all the more questionable. Even its initial shock effect is likely to diminish with repetition and turn into a minor irritant. Furthermore, counter arguments have already been developed by a number of countries which have claimed that, since they have not exploited any poor countries, they do not have to expiate their sins as do other rich countries.

Almost as fundamental as the limitations of preaching for more and better development finance is the lack of collective bargaining power of the recipients of such finance. Conditions for negotiating trade concessions or development aid are radically different from those in labor-management bargaining. While the trade-union approach may serve a useful purpose in creating a united front of developing countries and cementing their solidarity when presenting a program of action, it is in itself insufficient to exact concessions from the developed countries. For, unlike trade unions, the developing countries banded together are not in possession of power, such as a threat to strike, which will affect the vital interest of those on the opposite side of the bargaining table. As a result, the developed countries are not in a hurry to grant demands by the developing countries; in contrast, there is an inherent need for an agreed solution in labor-management collective bargaining in order to avoid an impasse which would ultimately hurt both sides. Attacks or demands on the developed countries in international forums can obviously be ignored. In trade matters, the basically weak bargaining position of the developing countries is not significantly enhanced by collective action, since there is very little they can do, individually or collectively, to force the developed countries to grant concessions. When it is clearly a matter of "aid," the possibility of any material increase in the bargaining strength by collective action of aid recipients is even more doubtful. Indeed, when numerical superiority gives a false sense of strength and inflammatory oratory substitutes for real negotiations, the

hard line copied from militant trade unionism may do more harm than good.

With this background in mind, it is not difficult to identify the specific reasons for the slow progress in bringing about an increased flow of development finance by current international efforts, whether through a "New Trade Policy" as spelt out in the United Nations Conference on Trade and Development or by a massive direct financial transfer of the Marshall-aid variety.

Problems of Implementing Key Trade Proposals

(1) Increased finance through reorientation of world commodity policies has been slow to bring into effect, mainly because a commodity-by-commodity approach necessarily draws attention to the diversity of interests between producers and consumers, not only between the two groups but also within each group. As a result, the path leading to any meaningful agreement among the interested parties is beset with obstacles. After many years of protracted negotiations, only a few commodities have been brought under any kind of international agreement. The difficulties involved may be seen in the repeated failure to arrive at mutually agreeable terms for an international cocoa agreement. The only commodity which has recently been added to the handful involved in international agreements is coffee. This achievement is, however, offset by difficulties encountered in the working of some existing agreements—notably sugar—which had long served as showcases of the type.

While proposals for the transfer of resources through a multi-commodity approach have also been the subject of international discussion, no concrete steps have been taken for the establishment of such an arrangement as the proposed Development Insurance Fund, which would automatically compensate for the major portion of short-fall of export proceeds. The reluctance of the developed countries to contribute funds for such a purpose has been the chief reason for lack of progress in this direction.[1]

Nor has the suggestion of an international organization of major commodity markets for ensuring "remunerative prices" to the developing countries been seriously considered by the countries concerned. The main obstacle to this approach is that improvement in the terms of trade for some producers of primary products brings deterioration on the part of their trading partners. This is a matter of serious concern for such importing countries as the United Kingdom. Recent trends indicate a re-

[1] For a more detailed discussion, see my "New Approaches to International Commodity Policies" (xerographed, 1959), cited in Boris C. Swerling, *Current Issues in International Commodity Policy,* Essays in International Finance (Princeton: International Finance Section, June 1962).

turn to the traditional commodity-by-commodity approach for the obvious reason that the interests of countries in particular commodities are often different.

(2) Progress in measures designed to increase finance through favorable treatment of the exports of manufactures from the developing countries, especially by preferential tariffs, has been equally uninspiring. Opinions among supporters of preference have been sharply divided between proponents of a general scheme and advocates of a selective scheme.

This reflects a basic conflict between the approach which seeks to minimize the degree of discrimination in world trade and the traditional approach of tariff-making industry-by-industry and country-by-country. Despite the apparent solidarity of the developing countries on the preference issue, the basic conflict between the general and selective approaches is also noticeable among them. In fact, there is a lack of real enthusiasm on the part of many developing countries that do not have actual experience or substantial interest in manufactured exports.

A number of pivotal countries (notably the United States) are, moreover, opposed in principle to tariff preference. Schemes which depend on collective action by the developed countries are necessarily impractical unless all the pivotal countries are in favor of them. Detailed negotiations are, at any rate, not contemplated prior to the conclusion of the Kennedy round of negotiations, since a number of pivotal countries have placed the negotiations, chiefly among the developed countries themselves, on a higher priority than special relations with the developing countries. The pioneering effort of the Australians in introducing preferential duties on imports of selective manufactures from the developing countries has not been duplicated by other countries. International discussions have, by and large, hardly moved from a debate of general principles to actual negotiations.[2]

Increasing Stringency in Aid Finance

In the realm of direct financial transfers, the lack of progress is likewise striking. The flow of official resources from the developed to developing countries has accounted for a smaller portion of the national product at the midpoint of the "Development Decade" than at its beginning. The chief reason for reluctance on the part of the developed countries to make larger appropriation of public funds for the purpose of development finance has been their generally tight budgetary situation. Foreign assistance is not only in competition with domestic expenditures

[2] For a more detailed discussion of the intellectual foundations and negotiating strategies of preference, see my forthcoming article on "Preferential Schemes: A Reappraisal" to be published by Banca Nazionale del Lavoro *Quarterly Review.*

—in which national security and welfare are high in priority—but also with programs of tax reduction, which have considerable public appeal. In many developed countries, moreover, aid to certain depressed areas or disadvantaged groups has received higher priority than foreign assistance, in line with the principle "charity begins at home."

The usual reasons for budgetary constraint in allocating development finance have been reinforced by certain recent trends in the developed economies. With virtually full employment, the possible use of capital exports as an instrument of pump-priming has become an academic matter. Even when pump-priming is still judged necessary, the wide acceptance of direct domestic measures has rendered the foreign-aid alternative less attractive.

In the context of full employment, capital is indeed often looked upon as a scarce resource even in the developed countries. The transfer of resources to the developing countries has been looked upon as a real cost to the exporting countries, in terms of sacrifice in rate of growth of the economy.

The pressure on real resources is most clearly shown in the balance-of-payments deficits of many important capital exporters, notably the United States and the United Kingdom, in recent years. A natural reaction to such a phenomenon is the pruning of all expenditures on the external account. While it is true that the deficits of one group of developed countries are largely reflected in the surpluses of another group, there is usually an asymmetry in the domestic adjustment to payments developments as between the surplus and the deficit country. For, under present circumstances, there is little pressure on the surplus countries to make a speedy adjustment to reverse the situation.

Reluctance to expand the quantity of aid finance is paralleled by difficulty in improving the terms of finance. Evidently, these two aspects are closely related. The tying of aid to procurement in the donor country, which is one way of hardening its terms, has, for example, been chiefly motivated by the need to minimize the balance-of-payments impact of the outflow. Likewise, shifts from grants to loans, rises in interest charges, and shortening of periods of grace and repayment have been consequent upon generally tight money markets under inflationary pressures.

Under these circumstances, there is as yet little indication that the current state of impasse in development finance will be overcome, either by massive concessions in the realm of trade or by an upsurge in direct transfer of resources and improvement in terms of finance. While efforts in these directions should be continued, it is not too early to seek new initiatives in development finance. These initiatives should, moreover,

not be viewed as alternatives to either trade or aid; they could be a complement to trade and aid in a concerted program for action.

NEW INITIATIVES AND PROPOSALS

Before the content of new initiatives and proposals is outlined, the main orientation should be made explicit. To start with, the almost exclusive emphasis usually placed on the side of requirements (demand) for finance must be counterbalanced by an awareness of the supply side. This is not to lose sight of the fact that the whole purpose is to meet the requirements of the developing countries and that unless the need for development finance has first been established, there is no basis for seeking the finance. Yet, once the requirements are demonstrated, pressure of demand will not ensure the supply, and the "elasticity" of supply with respect to external pressure may be very low, if not negative. In such a case, the limiting factor rests clearly with the supply side. A breakthrough in development finance is, therefore, more likely to come about by probing possible alternative sources of finance from the developed countries than by repeated pleas from the developing countries.

This means that the problems of the developed countries themselves must be faced squarely. Too often proposals for increased flow of development finance and for better terms are based on the assumption that the rich countries are endowed with abundant resources and enjoy self-sustained growth not beset with any difficulties of delicate balance. Thus, requests are often made for increased budget allocation for foreign assistance without reference to a ceiling on aggregate expenditure designed to contain inflationary pressures. Likewise, donors are urged to untie their aid from restricted sources of procurement, even when confronted with severe payments deficits.

It is true that, if the developed countries were to assign a sufficiently high priority to development finance, the task of fulfilling the requirements of the developing countries would not be too burdensome. The approximate order of magnitude involved in the transfer of resources from the developed to developing countries need not be significantly larger than one per cent of the gross national product of the donors. But, in addition to trade-union type of pressure on the developed countries or altruistic preaching to them, a more effective approach may be the working out of devices which will bring about an increased flow of development finance with due regard to the problems of the developed countries.

Such devices imply a strategy quite different from the prevailing practice of condemning all measures which the developed countries themselves have introduced in seeking to minimize the adverse effects of development finance on their economies. In saying this, one is not

condoning such restrictive practices as tying of aid procurement to particular sources of finance. Evidently, the quality of aid may be unfavorably affected when restrictive conditions are imposed. Even here, however, the proper strategy for promoting development finance is not to demand the removal of all restrictions. A good example is the flow of food aid when it is primarily a matter of surplus disposal. It would be entirely unrealistic to suggest that aid in kind is less efficient than cash, and that therefore food aid should be replaced by a transfer of freely usable currencies. The strategy should rather be to seek ways and means of minimizing the harmful effects of restrictions. Again, to use food aid as an example, if the choice is between aid from surplus disposal and greatly reduced aid, attention might be called to the effect of such aid on food production in the recipient country or to means of avoiding distortion in commercial trade.

But, more important, the strategy is not limited to ameliorative or safeguard measures; rather, it should turn the otherwise restrictive measures into positive programs. For, in the actual practices of the developed countries in grappling with their own problems are to be found ingredients for the new initiatives in development finance, consistent with the major policy goals of the providers of finance.

Finance through Trade Policy

The keynote of these new initiatives is that development finance shall not be restricted to a direct transfer of resources, purely and simply. Nor has it been, in practice. It is often intertwined with other measures. Some of these may be adopted for the sole purpose of favoring development finance, but most of them may owe their existence to other considerations, with the element of aid attached largely as a rider.

Recent discussions on trade policy amply demonstrate the preoccupation with aid through trade. It is for this reason that much of the contrast between trade and aid noted by writers several years ago is hardly relevant today. For, with the infusion of aid with trade and the proliferation of types of aid—ranging from specific projects to aid in kind, tied aid, and outright cash grants—the distinguishing features between pure trade and pure aid have lost much of their sharpness in the real world.

It cannot be overemphasized that if the trade initiative can bring about a significant breakthrough, all the needs of development finance may be met. But this is neither contemplated nor likely. Such resounding success is not contemplated by policy-makers, as the continuous need for direct transfer of resources from the developed countries has been emphasized in all trade discussions, although current interest in trade stems in part from a realization of the limitations of such direct transfers.