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NEW PROPOSALS FOR THE INTERNATIONAL FINANCE OF DEVELOPMENT

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FRITZ MACHLUP, Director
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-

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.

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

For a more detailed discussion of the intellectual foundations and negotiating strategies of preference, see my forthcoming article on “Preferential Schemes: A Re-appraisal” 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 the 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.
Nor is it likely in the immediate future, because the degree of success of the trade initiative bears an almost inverse relationship to the ambitiousness of the scheme.

As has already been pointed out, whenever trade arrangements have required a fundamental change in doctrine or a substantial transfer of resources, progress has been slow. In contrast, measures which may be adopted as a by-product of other policies have enjoyed relatively easy acceptance. An example of this type is the lack of resistance on the part of the developed countries in the Kennedy-round negotiations to the waiving of strict reciprocal concessions by the developing countries. Although this involves a basic change in one of the fundamental principles of trade negotiation, it is accepted not primarily as a deliberate revision of doctrines but as a matter of convenience for facilitating the negotiations, which are chiefly concerned with relations between the developed countries.

Although it is not the primary purpose of this essay to suggest reorientation of key trade proposals, the application of the above analysis points to a new emphasis which will render most of the trade proposals less ambitious and at the same time more practical. A concrete illustration of such reorientation forms the subject of another essay on preferential schemes, already mentioned.

What is to be emphasized here is a broad extension of the principle of aid from the trade area to many other important policy areas. If an element of aid can be injected into trade, the same is possible for other areas. Such an extension is not to be viewed as a substitute for direct financial transfers or trade concessions but as a natural sequel to aid and trade. Nor is it to be viewed as a retreat from a vigorous attack on the problem of development finance. On the contrary, a partial attack is to be replaced by a total attack. Instead of merely asking how much money the developed countries should donate to the developing countries, or how a new trade policy can aid these countries, the new approach to the international finance of development seeks to find out what the developed countries can do for the developing countries in all areas of policy—whether national planning, government procurement, tax arrangements, or administrative measures—that are consistent with their own interests.

Finance through National Planning

Even if development finance is limited to direct aid and aid through trade, a certain amount of national planning on the part of the developed countries is required. Without appropriate forward planning, the adjustments within the domestic economy necessitated by the granting of development finance are likely to be irritating, if not painful, and thus
constitute a major obstacle to the flow of such finance. An example of this sort is the effect which an international commodity agreement may have on domestic agriculture. Similarly, restrictive measures imposed on imports of cotton textiles from the developing countries may well reflect a preoccupation with domestic considerations in the developed countries. It is unrealistic to brush aside these considerations, because sovereign nations and elected representatives are unwilling or unable to ignore them.

The relevant question is how a government should deal with the problems of adjustment. Such adjustment is not limited to the passive role of ameliorating the difficulties by such measures as relocation and retraining. Nor is it limited to the problems arising from trade policies. It relates to the entire design and implementation of a national development program. This is not to suggest that the major goal of national planning in the developed countries should be to benefit the developing countries; nor is the goal to be limited to easing the adjustment required by aid and trade. On the contrary, in setting national goals the question should be asked whether, in addition, the purpose of facilitating the development of the developing countries—or of providing development finance in the broad sense—can also be fulfilled.

In countries where the economy is centrally planned, forward design for all forms of development finance is, of course, crucial. No amount of tariff concession granted to the developing countries, for example, can be effective, unless the economic plan allows or provides for imports of the commodity in question. But this consideration is not limited to the centrally planned economies; indicative plans, such as exist in a number of Western European countries, can also play an important role in accommodating the developing countries. The pattern of trade relations with the developing countries is obviously molded by the pattern of domestic production and growth envisaged in the plan. Even for those countries which do not have a formal development plan, there are, in fact, important policies and programs shaping the development of particular economic sectors, as well as the economy as a whole. Agriculture and cotton textiles are cases in point. Food aid to developing countries requires not only appropriate policies for trade, but also the setting of production goals consistent with the feeding of the food-deficit areas. This is becoming especially clear with the gradual disappearance of food surpluses. An essential feature of the “Food for Peace” program is therefore the attention that is paid to planning domestic production. Further examples of the importance of domestic planning may be found in the case of sugar and cotton textiles. The importing of these commodities from the developing countries may be greatly facilitated if, by deliberate planning, the domestic beet acreage is reduced.
and the domestic textile industry concentrates on production of the finer grades.

Appropriate national planning, especially for the structure of industries, on the part of the developed countries can thus serve the same purpose as an explicit transfer of financial resources to the developing countries. Although conventional accounting does not usually permit a proper assessment of such an effort in precise financial terms, a comprehensive policy for finance of development can hardly afford to ignore planning.

A practical step toward finance through national planning in the developed countries would be a systematic review of all development plans and the instruments for implementing them from the standpoint of exactly how they assist the developing countries, directly or indirectly. Parallel with the establishment of a foreign-assistance chapter in national budgets or the recent addition of a trade-and-development chapter to the General Agreement on Tariffs and Trade, a chapter on planning in favor of developing countries in all its ramifications should be a part of development plans of the advanced countries. Indeed, the developed countries have often urged the developing countries to engage in economic planning in the interest of effective utilization of aid; an equally persuasive argument can be advanced for planning on the other side. The benefit from such an effort is, moreover, not limited to improved aid as such to the developing countries but tends to promote rational distribution of industrial activities and division of labor among countries. In the short run, what cannot be achieved by an attack on the trade regime or aid finance may be made possible by skillful domestic planning consistent with the political tenets of the country. In the longer run, the self-interest of developed countries will be served by better allocation of resources, regardless of the aid issue.

**Finance through Procurement Policy**

In many cases, the way in which a national plan is actually implemented or the manner in which the government conducts its daily administration is more important than the design of the plan itself. Government procurement is a case in point. Owing to the gradual expansion of government functions in recent years, the share of such procurement in total national expenditures is sizable. At the same time, it is clear that most governments favor domestic sources of procurement. The exact manner of attaining this end is often not obvious, nor is it usually authorized by specific legislation. In some cases, preference for domestic products is based on legislation; in the United States this covers about $35 billion of expenditures annually in recent years. On close examination, however, much of the practice is seen to be purely
a matter of administrative decision: the Buy-American Act did not specify the precise cost differential that would justify foreign procurement. For many years, the maximum reasonable cost differential was entirely subject to administrative decision and informal coordination among the agencies until an Executive Order provided a more definitive guideline. Even this guideline allowed the head of each agency to make exceptions to the Buy-American rule. As a result, the Defense Department has used the 50-per cent differential, while other agencies have used a 6-to-12-per cent differential.

A minor revision in procurement practice in favor of the developing countries would have a substantial effect on these countries. For the United States alone, a one-per cent diversion of expenditures from domestic sources to developing countries would yield several hundred million dollars for the latter. One simple measure of a "development finance rider" to procurement policies is to treat the developing countries on the same terms as domestic suppliers. Even if this is not completely acceptable, a more lenient differential applied to the developing countries will go a long way in this direction. In any case, procurement practices such as prohibition of the use of government funds for the purchase of specific goods from the developing countries should be reconsidered.

That this proposal is feasible has been demonstrated by experience. In the United States, for example, certain Canadian materials and goods have actually been treated as American for procurement purposes. Moreover, in connection with its tying of aid to procurement, "an orderly cessation of commodity procurement" has been limited to most of the developed countries, while purchases in the developing countries are permitted.

The adoption of a procurement policy in favor of the developing countries has several important advantages. In the first place, it is not in direct conflict with the primary policy objective of favoring domestic suppliers, because the major competition comes from other developed countries. Moreover, it can be implemented as soon as a policy decision is made by the government, without prolonged legislative debate and action. Furthermore, it is sufficiently flexible so that under special circumstances the favorable treatment of the developing countries can be terminated on the ground of national interest. Finally, and perhaps most important, it can be implemented by a single country or any number of countries, and thus no prolonged negotiation for international agreement is necessary. Indeed, since the favorable treatment of the developing countries is largely at the expense of other developed countries, there is an automatic, though admittedly imprecise, mechanism for a broad distribution of the real burden of such a measure among the
developed countries, including those which do not make such a provision.

It may be argued, on the other hand, that such favorable treatment for the developing countries is based on discrimination in favor of domestic suppliers that is in itself undesirable. In order to avoid possible misunderstanding, it should be made clear that the development-finance rider (as described above in connection with procurement policy) is not to be used as justification for a Buy-American type of discrimination per se. At the same time, if such discrimination already exists, a development-finance rider constitutes an improvement. Moreover, so long as the source of development finance is varied and is not exclusively dependent on this channel, there is little danger that finance through procurement policy would corrupt the entire system of government procurement.

**Finance through Tax Policy**

The use of fiscal instruments in favor of developing countries need not, of course, be limited to the expenditure side. Thus far, the use of tax measures to stimulate development finance has been largely neglected. Although a few examples of actual practices may be found, no systematic effort has been made to obtain appropriate measures in every developed country for this purpose.

Most recent discussions on tax measures in favor of the developing countries have been related to trade in primary commodities. The concern about high internal taxes on commodities chiefly exported by the developing countries has been a logical extension of the appeal for the removal of tariffs and revenue duties on such commodities. Some progress has been made in this direction in respect of certain tropical products.

It is the use of tax policies in favor of capital flow to the developing countries that is potentially of great importance. Thus, tax exemption for income from bonds issued by lending institutions chiefly engaged in the financing of projects in the developing countries can materially increase the flow of resources through this channel. The favorable tax treatment of obligations of the World Bank is a case in point. Yet in this respect the practices of the developed countries are by no means uniform.

More broadly, investment incentives have been granted with respect to activities in the developing countries. The Western Hemisphere Trade Corporations Act of the United States has stipulated, for example, a reduction in tax rates for qualified corporations. In the Federal Republic of Germany, the Development Aid Tax Law of 1963 provides a number of tax advantages to investors in the developing countries. Other tax provisions favoring the developing countries have also been reported in such countries as Japan and Sweden.
At the same time, there are many neglected areas in which a relative tax disadvantage actually exists for investment in developing countries. For example, such investment does not usually enjoy the same accelerated depreciation or investment allowance as domestic investment. In such a case, removal of the tax disadvantage would be a first step toward favorable treatment of the developing countries. Here again, treatment of investment in the developing countries at least as favorable as domestic could not negate the main purpose of stimulating domestic investment. The marginal importance of the developing countries in total investment will guard against a material conflict with domestic objectives.

In addition, most of the advantages of finance through procurement policy mentioned in the previous section would in general apply to tax measures. What needs to be emphasized here is that the tax systems of different countries are extremely varied. Whether it is a matter of interpretation of existing legislation or authorization by new legislation depends on particular instances. But, whatever the tax system, favorable treatment of the developing countries through tax exemption or incentives can be fairly easily accomplished without a fundamental restructuring of national systems or international harmonizing of measures. It would be quite feasible and practicable to have "development finance now and harmonization or co-ordination later."

On the other hand, it may be contended that finance through tax policy is not as pin-pointed in its effectiveness as a given expenditure of direct aid. Indeed, the benefits accruing to the developing countries from tax policy, as those from trade policy or procurement policy, are usually not imputed in the conventional recording of international financial flows. Moreover, concern has been expressed as to whether artificial incentives for capital flow to the developing countries might not violate the principle of neutrality in tax policy. Furthermore, insofar as tax policies largely affect the profitability of private investment, the particular form of capital flow may not be welcome in certain developing countries.

The answer to these arguments is not difficult. As far as the degree of pin-pointedness is concerned, it is not always a decisive consideration in the choice of policy. Even in the case of direct financial transfer, program finance is, for example, less pin-pointed than project finance, but there are circumstances in which a shift of the weight in favor of the former may be desirable. Moreover, some degree of selectivity may be introduced in favorable tax treatment by laying down certain conditions of eligibility.

With respect to the principle of tax neutrality, it will be observed that in the context of aid, neutrality is hardly relevant. The whole pur-
pose of the tax policy in favor of the developing countries, as in the case of direct aid, is to effect a reallocation of resources which would otherwise not take place. Moreover, if the tax incentives largely operate on private investment, the market mechanism still operates as a regulator of investment allocation among the developing countries, while aid allocation is entirely a matter of government decision. But, if it is judged that private profitability alone should not serve as a guide to resource flow, there is nothing in the tax policy itself to preclude purposive direction of private investment, especially on the part of the recipient countries themselves, in accordance with their national development strategies.

Finance through Credit and Monetary Policy

On the borderline between fiscal and monetary policies are measures such as the recent United States Interest Equalization Tax, which exempts capital flows to the developing countries from the levy. Several features of this measure are noteworthy. In the first place, this is another illustration of willingness to grant favorable treatment to the developing countries as long as the major aim of national policy—in this case meeting the payments deficit—is not negated. Moreover, such a measure can be applied flexibly. Precisely which countries should be considered "developing" may vary according to the particular purpose. For example, a number of Middle Eastern countries, judged not to be in need of an inflow of capital, have been treated as developed countries.

In a less formal arrangement, executive guidelines for the flow of private investment have also accorded favorable treatment to investment in the developing countries. In the United States, the new guidelines of December 1965 for direct investments asked each of about 900 nonfinancial corporations to hold its investment in the advanced countries to a specified level. In the United Kingdom, the voluntary program in 1966 requested British residents to refrain from investing in certain sterling countries (Australia, New Zealand, South Africa, and Ireland), considered developed, unless capital expenditures satisfied certain criteria of return or could be financed from funds obtained abroad. Furthermore, the guidelines governing American bank credit to foreigners have accorded priority to funds destined for the developing countries. Although the precise benefit to be derived by the developing countries from these measures may be limited, the principle of specially favorable treatment of the developing countries has been established beyond doubt.

In a more positive measure, the provision of special credit facilities for the developing countries is, of course, the function of many international institutions, such as the World Bank group and regional development banks. The extension of credit on concessionary terms by
these institutions is well-known. This is made possible by a series of measures adopted by governments: notably, authorization for financial agencies to hold obligations of development institutions, guaranteeing of these obligations, as well as budgetary appropriations for their financing, and tax exemptions. What is abundantly clear in recent years is that favorable treatment of the developing countries has become more explicit. For example, recently the interest rates charged on loans extended by the World Bank to developing countries have actually been lower than those to developed countries. Inasmuch as the interest differential cannot be explained by commercial considerations, there is clearly an element of deliberate subsidy to the developing countries.

A proposal for enlarging the flow of resources to the developing countries through an interest subsidy has indeed been advanced by Horowitz. In essence, the proposal is to shift a part of the capital flow from budgetary allocations to the capital market. It is not the purpose of the present essay to examine the relative merits of such specific proposals. It is sufficient to point out certain broad implications. From the point of view of transfer of real resources, it makes little difference, of course, whether the transfer is through the budget or the capital market. Moreover, it is well known that the size of the international capital market is as yet very limited, and is subject to great strains in periods of tight money, as witnessed in recent months. On the other hand, there are important advantages in financing through the capital market.

A flow of funds through the capital market to the developing countries may be much easier to secure than appropriation of budgetary funds, since decision-making in the former may involve no more than acquiescence on the part of the government once the institutional framework in favor of such a flow has been established, while a budgetary provision inevitably involves an explicit political decision and legal process. Thus, for the same amount of financial flow to the developing countries, financing through the government budget directs attention to the necessity of cutting competing expenditures or increasing revenues, while financing through the capital or money market may require certain delicate adjustments in liquidity management—which is not closely linked with the purpose of development finance. Even from the point of view of balance-of-payments requirements, it may not be practical to adjust budget allocations to the developing countries to any great extent, increasing the foreign-assistance budget in a period of payments surplus and decreasing it in time of deficit. Nonetheless, it may be possible for a surplus country to increase its holdings of obligations of such institutions as the World Bank, or, conversely, for a deficit country to decrease its holdings.

In this connection, the flexibility of adjustments in development fi-
inance to meet variation in payments conditions would be greatly facilitated if mechanisms for such adjustments were established. The various programs of cooperation between central banks would be a step in this direction. A more formal arrangement could be made by providing rediscount facilities or repurchase arrangements by the international monetary authority for certain international obligations, such as those of the World Bank. In this way, a liberal policy toward the holding of a portion of international liquidity in the instruments of development finance, such as World Bank bonds, would be encouraged.

This leads to a consideration of the role of the international monetary system in development finance. A series of measures aimed at improving this channel have, in fact, been adopted in recent years.

The compensatory-financing facility, introduced in 1963, and broadened in 1966, at the International Monetary Fund, was explicitly designed to assist producers of primary commodities facing shortfalls in export proceeds due to causes beyond their control. Less formal methods of easing the conditions for Fund credit to the developing countries have also been suggested. More generally, proposals have been made to link the reform of the international monetary system with the provision of finance to the developing countries. It is probably unrealistic to assume that grandiose schemes such as the Stamp Plan will reach the negotiating stage in the foreseeable future, since the primary function of international monetary reform can hardly be subservient to the provision of development finance. On the other hand, it should be recognized that in any monetary reform special attention to the needs of the developing countries is not necessarily inconsistent with the principle that the tail should not wag the dog. It is encouraging that international opinion has placed more weight on the stake of the developing countries in such a reform. The Emminger Report to Ministers and Governors of the Group of Ten has exhibited a greater appreciation of the interests of the developing countries than the Ossola Report to the same group, submitted earlier, and current discussions on various proposals are no longer confined to the financial centers but are beginning to include representatives of the developing countries. Indeed, concern for the interest of the developing countries should by no means be limited to the occasion of an international monetary reform; it is both necessary and feasible under any system, including the existing one, as has already been demonstrated by such special provisions as the compensatory facility at the Fund.

Finance through Other Policies

The foregoing list of possible instruments by which the flow of resources to the developing countries might be augmented is far from ex-
haustive. Even this limited discussion, however, should demonstrate beyond doubt that the scope of possible sources of development finance, in the broadest sense of the term, can be considerably larger than at present. At the same time, the categories within which each instrument might be classified are not watertight. It has already been indicated that administrative arrangements might shade into many categories. Thus, administrative provisions regarding government procurement may be considered under national planning, as well as fiscal policy; foreign-exchange controls border on fiscal and monetary policy.

In order to make it clear that the list is designed to indicate the breadth of coverage, a few examples which may not readily fall within a particular category already enumerated are given below.

A well-known administrative obstacle to expansion of trade with the developing countries is the strict, sometimes harsh, interpretation of sanitary regulations and specifications. Thus, beef imports from certain developing areas may be prohibited simply because of a reported occurrence of a certain cattle disease.

Another administrative obstacle affects the flow of skilled personnel to the developing countries. Rules regarding personnel often discourage overseas service as they involve loss of seniority or other privileges. Measures to ensure that such service would not entail disadvantages would go a long way toward promoting effective technical assistance, which is an important counterpart of the financial flow. In a more positive way, such service may be considered as part fulfillment of essential conditions for promotion (as in the United Kingdom) or of requirements for national service (as in France).

A further example of encouraging the flow of resources to the developing countries other than by direct aid or even explicit subsidy is through government guarantees. In a number of countries, guarantees against investment and credit risks have been designed mainly for the benefit of the developing countries. For example, since 1959, the Investment Guarantee Program of the United States has been directed specifically to these countries. Insofar as the premium paid for the guarantees may be low relative to the risk there is an element of implicit subsidy. This subsidy appears also to exist in connection with export-credit insurance, for which the same premium may be charged for the developed and developing countries irrespective of apparent differences in risks.

These and other conceivable measures of development finance in the broad sense are familiar when applied to disadvantaged groups domestically. Very few will maintain that for such groups a simple method of aid, such as the distribution of a dole, is adequate; rather, the full
weight of national policy is brought to bear on the issue. This should also be true with respect to international aid to the developing countries.

CONCLUSION

This essay is a response to repeated calls from statesmen at an important turning point in history for new ideas on development finance. The postwar years will be remembered as an age of rising concern for the developing countries. The enormous task of economic and social transformation of these countries has become the focus of international attention, and the need for development finance from external sources has been generally accepted. Yet, by the middle of the nineteen sixties, it appears that further progress in extending development finance from the rich to the poor countries is encountering serious difficulties. Indeed, the flow of resources in this direction has remained on a plateau since the beginning of the decade. Unless a fresh impetus is given to efforts to raise such finance, there is grave danger that the impasse may turn into a crisis.

The basic difficulty encountered in efforts to enlarge and accelerate the flow of development finance lies in the limitations of the current approach. The organization of the developing countries as a pressure group in presenting demands to the developed countries has served a useful purpose in sharpening the issues and keeping them alive. At the same time, the analogy of this approach with trade unionism is misleading. For, unlike the demands of trade unions, pleas by the developing countries are not backed by economic power which will impel the developed countries to make concessions in order to protect their own vital interests. Indeed, hard bargaining on the part of the developing countries may serve to harden the attitude of the developed countries.

For this reason, it has been advocated by some that the developing countries should “go it alone.” This approach has the great merit of reliance on self-help, which must be the key to development, no matter what quantity of external resources may be made available. At the same time, this approach is not especially relevant to external finance as such, except in an indirect way—that self-help is a condition for external aid. It is of limited applicability when a go-it-alone policy concerns such means as monopoly power in the sale of primary commodities. The success of this approach depends on the universal participation of producers and the lack of substitutes, as well as inelastic demand. Very few commodities satisfy all these conditions and, even if they do in the short run, they are less likely to do so in the longer run.

To the extent that decisions on the flow of development finance rest mainly with the developed countries, there is no alternative to an approach that would take into account the needs of the developed coun-
tries as well as of the developing countries. This does not imply that the solidarity of the developing countries is no longer needed; but it does recognize that solidarity by itself is not a sufficient condition for obtaining development finance.

The growing proliferation of forms and methods of development finance is a reflection of the complex considerations that confront the developed countries. Loans are tied with respect to source of procurement when the capital-exporting country is beset with balance-of-payments problems. Food is distributed in kind when the donor country is burdened with surpluses resulting from domestic agricultural policies. Finance is earmarked to specific projects partly because this makes it easier for the capital exporter to account to the voters for the foreign-assistance programs.

It is understandable that even more complex considerations on the part of the developed countries should enter into policies of finance of development through trade. For the trade relations of the developed countries with the developing countries are only marginal in importance, and it can hardly be expected that the major trade policies of the developed countries will be shaped mainly by these relations.

Faced with this situation, two broad approaches are possible. One is to seek a reversal of this proliferation, which would not only do away with the multifarious restrictive measures and conditions attached to aid, but also render most of the schemes for finance through trade unnecessary. This has the supreme virtue of simplicity and purity; but it either assumes a scale of priorities for the developed countries that may be too good to be true, or contemplates a world of pure forms which bears little resemblance to the real situation. The other approach is to start with the given situation and to probe alternative channels when existing ones are blocked with stubborn obstacles. While it does not imply a retreat from existing approaches, it does admit a further proliferation of forms of development finance as well as a variety of extraneous considerations as far as the developing countries are concerned.

The present essay considers the latter approach as more realistic at the present historic juncture. In the first place, experience shows that the flow of resources to the developing countries may result as a byproduct of other measures, as well as the outcome of a direct measure. For this reason, the principle of development finance need by no means be limited to direct financial flow or to trade but may be applied to most policy measures, including national planning, fiscal and monetary policies, and administrative measures. The relevant question for each developed country is how each policy may augment the flow of resources to the developing countries. At this level of generalization the focus is not on whether finance through fiscal and monetary policies and the like
is better than direct aid, and even less on the relative merits of a particular instrument, although a more complex policy mix may be implied; it is on the need for broadening the scope of policy instruments. Some of the instruments may not yield any “financial” flows as conventionally defined by statisticians or reported by international agencies; but they should serve broadly the same purpose of fulfilling the requirements of the developing countries. In the ultimate analysis, it is the content of policy which must shape statistical conventions, and not the other way around.

The practical orientation of this approach is consistent with the fact that its needs are contained in the actual practices of many countries. These practices have often been hidden as by-products or been introduced with little outside pressure. Very little bargaining or trade-union type of demand has been involved. At the same time, it must be recognized that such practices would not have been possible without general acceptance of the need for development finance in the broad sense.

A further advantage of this approach is that it can easily be initiated by a single country, especially by a relatively important one. The precise measure can vary according to the national goals and institutional framework of the particular country. Thus, in fiscal measures in favor of the developing countries, it is perfectly feasible to take into account the particular system in use and all the intricacies it implies. A corollary of the above is that the real cost of the measure is at least partly passed on to other developed countries. It is not essential, therefore, for all the developed countries to participate in an agreed program. The nonparticipants will automatically bear a part of the cost. At the same time, very few countries would in fact bear a substantial cost, since the quantitative importance of the developing countries in the world economy, whether in trade or finance, is likely to be small. The marginal importance of such measures for the developed countries directly and indirectly affected points to the relative ease with which these measures may be adopted.

It is true that finance through national planning and fiscal and monetary policies cannot be a perfect substitute either for direct aid or for trade. But such a policy can go a long way toward augmenting the supply of development finance.

Although a precise quantitative calculation of the benefit to the developing countries through these various measures cannot be attempted here, there is no doubt that, properly imputed, an increase in the flow of development finance of several billions of dollars per year—considered necessary by president of the World Bank George D. Woods—is feasible. Moreover, the lack of precision in the exact impact of this approach as compared with other more direct approaches is only
apparent. Certain financial flows appear to be readily measurable only because conventional accounting methods have been adopted. The true significance of project financing, tied aid, aid in kind, soft loans and hard loans, is, in fact, extremely complicated, when they are examined closely. A dollar’s worth of aid or capital flow through one form is by no means equivalent to a dollar in another form, and uniform coefficients of conversion of various forms of flows into equivalents do not exist except under restricted assumptions. When the measures are more complicated, it ceases to be meaningful to give an estimate of the true impact without knowing all the relevant factors. For example, the impact of the International Coffee Agreement can be properly assessed only if a comparison can be made between the situation under the terms of the Agreement and what might happen without the Agreement. Similarly, each of the measures that might conceivably be adopted must be specified before an assessment of the impact is possible. What is certain is that the additional measures discussed can be sufficiently important to yield a significant increase in the flow of resources over and above conventional direct aid or aid through trade.

If this total approach is accepted, the immediate practical step for the developed nations to take would be to review all their policies and practices that might affect the developing countries. In most cases, new or additional measures in favor of these countries can be simply interpretation or supplement to policies and programs without fundamental changes in major national aims. At the international level, it may not be premature to review such policies, as has already been done to some extent in connection with deliberations of the United Nations Conference on Trade and Development, especially relating to finance. It is perhaps time to make the broadening of the scope more explicit and extensive and to prepare a World Conference on National Planning in Favor of the Developing Countries, a World Conference on Fiscal Policy in Favor of the Developing Countries, and so on. For economic relations between the developed and the developing countries are certainly not limited to trade matters, but extend to all fields. A thorough discussion of all possible measures, separately and jointly, would appear to be a logical sequel to the recent developments in aid and trade. It may pave the way toward solving the current impasse in development finance.
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