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International Financial Issues in Foreign Economic Assistance to the Less Developed Countries

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The purpose of this paper is to discuss some of the major international financial issues of current importance in the provision of foreign economic assistance to the less developed countries (LDCs). These issues are to be seen against a background of increasing criticism of foreign aid, especially in the United States where the aid proponents have experienced difficulties in convincing Congress that aid is observedly a catalyst to development and that it is in the interests of the United States to become heavily involved *via* the aid programme in the internal affairs of recipient countries. The questioning of foreign-aid commitments in the United States and elsewhere has been reflected in the fact that there have been only modest increases in official aid disbursements especially since 1961. These developments have occurred despite the widely held belief that many LDCs could effectively use more aid. They have also come at a time when there are signs of mounting debt-service requirements that particular LDCs may find hard to meet in the near future.

In what follows, we shall focus in particular in Section I upon the programmes of Development Assistance Committee (DAC) members, giving special attention to the policy issues arising out of bilateralism in aid giving, the emphasis on project financing, tied aid, surplus commodity aid, and special problems created by the increased use of suppliers' credits. We shall then treat briefly in Sections II–IV some of the important financial characteristics of the assistance programmes of the centrally planned economies, policies of the multilateral institutions, and policies of the recipient countries. Attention is directed in Section V to possible new directions in development assistance policies especially with regard to aid tying, suppliers' credits, and debt rescheduling. Some brief concluding remarks are given in Section VI.

I. DAC MEMBER COUNTRIES

The predominance of bilateral assistance

In recent years the DAC countries have disbursed on a bilateral basis about 80 per cent of the total net official flow of long-term financial resources to the LDCs.[1] This percentage would be even greater if account were taken in addition of total net private long-term flows.

This 80 per cent figure is in a sense an overstatement, however, because it does not reflect adequately the influences which international agencies have had on the flow of resources by their sharing of experiences, the studies they have made of development problems and the need for and the utilization of development finance, and the discussions and recommendations they have sparked. These institutions have also played a more direct rôle in affecting bilateral flows by influencing the sizable commitments which have been made in recent years through the activities of aid consortia and in the debt reschedulings which have been arranged for a number of LDCs.

It remains nevertheless that national interests are still and will continue to be reflected significantly in the assistance efforts of donor countries. This is borne out by the preferences which individual donors show for the financing of projects rather than programmes, the frequency with which they tie their aid through procurement restrictions, and the importance especially for the United States of surplus commodity aid, the substantial variation which exists in the terms on which assistance is extended, and the special incentives which are provided to encourage the expansion of exports.

Project and programme assistance

There has been a longstanding preference in both bilateral and multilateral assistance programmes for the financing of specific projects in developing countries. Thus, the preponderance of multilateral commitments is stipulated for project financing. According to the data in table 1, which cover the distribution by purpose of official bilateral assistance programmes, about 31 per cent of bilateral commitments in 1965 was made for capital-project financing. Although about 42 per cent was apparently allocated for non-project (i.e., programme) assistance, it should be pointed out that only 9 per cent was in the form of freely usable foreign exchange. The other 33 per cent evidently reflected in great part United States surplus agricultural commodity shipments. However, since these shipments are to some extent directed to consumption uses that have been especially created in response to the availability of surplus-commodity aid, the recorded contribution to programme finance would appear to be somewhat overstated.

There is a preference for project financing on the part of donors because projects deal with ostensibly tangible investments which produce recognizable returns. They can be subjected therefore to careful costing in terms especially of the amount of foreign exchange which may be necessary to fulfill specific equipment needs and to

TABLE 1 Distribution by purpose of official bilateral commitments, 1965

Country	*Non-Project Assistance (%)*							
	Capital project financing	*Current expenditure financing*	*Cash transfers*[2]	*Current imports financing*[3]	*Technical cooperation*	*Cons. and refinancing loans*	*Other*[4]	*Total*
Australia	22·6	10·1	53·8	10·5	3·0	—	—	100·0
Austria	—	—	—	93·3	6·7	—	—	100·0
Belgium[1]	4·9	0·4	—	1·3	31·3	0·8	61·1	100·0
Canada	71·5	—	0·2	22·4	5·9	—	—	100·0
Denmark	33·0	—	—	—	31·8	35·2	—	100·0
France	39·7	2·5	16·0	—	40·2	1·4	0·2	100·0
Germany	34·0	—	8·8	15·8	18·8	8·9	13·7	100·0
Italy[1]	46·0	—	5·4	11·6	3·9	31·9	1·2	100·0
Japan	28·5	—	0·4	10·4	2·8	37·0	21·1	100·0
Netherlands	24·2	—	48·7	—	27·0	0·1	—	100·0
Norway[1]	47·4	—	—	—	36·8	—	15·8	100·0
Portugal	—	—	58·4	—	21·0	21·0	—	100·0
Sweden	48·6	—	—	—	51·3[1]	—	—	100·0
Switzerland	75·5	—	6·5	—	18·0	—	—	100·0
United Kingdom	32·3	0·6	23·9	18·6	19·3	5·2	—	100·0
United States	26·4	—	4·0	54·4	13·2	—	2·0	100·0
Total	31·2	0·6	9·0	33·4	17·5	4·3	4·1	100·0

[1] Gross disbursements.

[2] Non-project assistance not directly linked with imports.

[3] Includes contributions in kind and agricultural surplus commodity shipments.

[4] Comprises mainly payments by Belgium of the interest and amortization of the external Congolese debt and reparations payments of Germany, Italy, and Japan.

Source: OECD *The Flow of Financial Resources to Less-Developed Countries, 1961–65* (Paris 1967) p. 228.

supply technical personnel and other requisites. They may also permit leverage to be exerted on the recipient through the financial discipline which the external financing will involve and by requiring a certain proportion of the investment to be met from local resources. Projects can furthermore be tailored by the donor countries to coincide with their particular export availabilities and at times to further their national prestige.

Project financing may have definite advantages to developing countries for reasons that are similar to some of those just mentioned. But there are drawbacks as well. This is especially the case if projects are defined too narrowly. Insufficient account may be taken therefore of the need for additional resources to finance expansion in other sectors and to satisfy increases generally in demand as income rises. It is also possible that distortions will be created if projects are financed subject to donor-country procurement specifications or to further donor-country prestige, and inadequate attention is given to development priorities, technical skills, and other resource availabilities in the developing country's economy. The reluctance to finance the local costs of projects may produce still further distortions by increasing the capital intensity of investment, forcing the recipient to turn to more costly external financing alternatives, and creating greater pressure on the recipient to resort to deficit financing.

There is a tendency, moreover, for project finance to be concentrated on relatively large investments. The consequence of this may be to retard the expansion of small-scale investment which does not lend itself readily to project financing but which nevertheless contributes importantly to development. It may be mentioned, finally, that the time consumed in project implementation and negotiation may slow down the utilization in the developing country of aid resources in general and thus have a retarding effect on growth.

Because projects have characteristics which lend themselves to discrete financing decisions, they will continue to be the main objects of external development finance. The prerequisite for programme financing is apparently a carefully drafted and consistent plan for the execution and financing of the recipient's development programme. The advantage of such a plan is the assurance that adequate consideration will be given by the recipient to provisions for overall growth, price stability, and balance-of-payments equilibrium. This is something which a project orientation cannot accomplish. The arguments in favour of additional programme assistance are therefore compelling. It is perhaps also worth stressing in this connection that programme assistance would by no means reduce the need for sound project evaluation. If anything, it would increase this need since it would be necessary to look comprehensively at all of the recipient's projects and to appraise the capacity and abilities of the recipient-country agencies that will handle the implementation and financing of the projects.

There has fortunately been increasing recognition on the part of donors and multilateral agencies of some of the limitations of project financing and the merits of and need for additional programme financing in a number of countries. The various aid consortia and consultative groups convened under the auspices of the World Bank (IBRD) and the Organization for Economic Cooperation and Development (OECD) have been influential in this respect. They have furnished a forum in which the provision and design of the resources of the donor countries and international agencies can be brought more effectively to bear in the fulfillment of the capabilities and needs of the LDCs.

Tied aid[2]

The emphasis on bilateralism and project financing has come increasingly to embrace the tying of aid by country source and end use. Thus, it has been estimated that during 1961–3 about two-thirds of the gross bilateral assistance of DAC member countries was contractually tied or otherwise limited.[3] This proportion may actually be higher now in view especially of the more comprehensive tying measures instituted since that time especially in the United States.

Aid-tying restrictions have political roots in the legislative processes in individual countries. These restrictions have been sought not only for administrative reasons but perhaps also to demonstrate that aid meant increases in the country's exports. The increased use of suppliers' credits and other devices to stimulate exports has furthered tying. But in recent years, especially on the part of the United States, aid tying has been extensively broadened because of balance-of-payments difficulties.

The object of United States tying restrictions is to curtail sharply the expenditure of aid proceeds by recipient countries on the export goods of the other more advanced countries. The reason behind this is that when the exports of these countries increased, they would be likely to accumulate additional foreign exchange reserves at the expense of the United States rather than to increase their imports from this country. It should be clear therefore that aid tying on balance-of-payments grounds is a reflection of the inadequacy of the workings of the international-financial mechanism of adjustment for the restoration of payments equilibrium among the more advanced countries.

Since the United States is the main country which has instituted tying on such a broad scale, it is instructive to consider briefly the effects this has had on its balance-of-payments. Thus, Bhagwati, on the basis of some information supplied by Alan Strout, has estimated that aid tying in 1966 may have 'saved' the United States as much as \$1·1 billion, which was equal to 39 per cent of total procurement in that year.[4] Bhagwati further estimated that the elimination of tying by all the DAC member countries simultaneously would have resulted in an estimated loss in export proceeds for the United States of about \$800 million in 1963 and \$688 million in 1964.[5]

These estimates of the foreign-exchange savings of tied aid must of course be interpreted with caution. This is because they were based upon an assumed proportion of 30 per cent representing the balance-of-payments 'gains' from aid tying, and upon the further assumption that untying aid would redistribute exports according to the market shares of DAC countries actually observed in 1962–4. The fact remains nevertheless that the foreign-exchange savings of tied United States aid are substantial and that the removal of tying would result therefore in a significant increase in the United States balance-of-payments deficit. The untying of aid under present conditions would have to be predicated therefore on multilateral action, with the surplus countries especially untying more than their proportionate share of total aid.

Looked at from the standpoints of the world as a whole and the LDCs in particular, there is a definite presumption that aid tying is an inefficient policy. This inefficiency will not be especially serious when the donor country can supply a broad range of goods at or close to world market prices. But the costs of inefficiency will become more substantial as the donor country narrows its range of available goods, becomes less competitive internationally and tolerates explicit or implicit collusion by domestic producers in setting prices for aid-financed goods. The disadvantages to the recipient will vary also depending on its availability of other external resources besides the tied aid. The more limited these other resources, the greater will be the reliance of the recipient on the tied aid and the greater therefore the possibility that this aid may not accord well with the recipient's needs and development priorities.

The excess costs of aid tying will of course vary from country to country. Unfortunately, there is only scattered information on what these costs may actually be in particular circumstances. It is difficult therefore to reach any general conclusion as to the most likely order of magnitude. Thus, for example, Bhagwati has analysed the spreads of bids on competitive tendering from 20 World Bank loans and 3 IDA credits amounting to a total of \$200·9 million in the years 1960–6. He measured the percentage of potential excess cost as the ratio of the difference between 'high bids' and 'successful bids' to 'successful bids'. His results indicated an average potential excess cost of 49·3 per cent, and 'that over 31 per cent of the value of contracts awarded . . . were characterized by potential excess cost of over 50 per cent, and 62·9 per cent of the value of contracts awarded were characterized by potential excess cost of over 30 per cent.'[6]

In his pioneering study of aid tying in Pakistan, Ul Haq arrived at an estimate of 12 per cent of excess cost on the basis of a loss of $60 million out of a total annual aid flow of $500 million in 1961–3. This was a relatively low figure which Ul Haq attributed to Pakistan's flexibility in seeking alternative suppliers and the relatively low proportion of tied aid to total aid.[7] In a study of six projects involving transport and harbour equipment undertaken in Iran in 1966–7, Eshag estimated an average excess cost of about 15 per cent on disbursements of $18·9 million. However, since the excess cost on dams and electric-power projects was estimated to be appreciably smaller, Eshag concluded that the average rate of excess cost on total tied aid received by Iran in 1966–7 may have been 10 per cent or less. He attributed Iran's ability to keep down these costs to its success in diversifying aid sources, the negotiation of untied global credit agreements, and the financing of parts of projects with its own foreign-exchange recourses.[8]

Many more case studies of recipient countries are needed before we could say whether in general the excess costs of aid tying are greater or less than, for example, 10–15 per cent. But whatever the correct percentage, it is clear that the nominal aid figures may substantially overstate the real value of the aid being transferred to the recipient countries.[9] Thus, projects undertaken with tied aid in recipient countries may turn out to be inefficient unless their costs can be written down or some other adjustments made. Moreover, to the extent that the tied aid is furnished in loan rather than grant form, repayment may possibly result in returning to the lender more in real value than was actually received. This may be the case even if the loan is provided on soft terms.[10] Finally, it does not seem completely equitable when loans are tied to ask the recipient to make repayments in freely convertible foreign exchange.

It is clear from the foregoing discussion that really fundamental progress in removing aid-tying restrictions depends upon needed reforms in the international monetary system. Making the system more stable by reducing or eliminating the rôle of the dollar as a reserve currency and establishing a more effective balance-of-payments mechanism of adjustment would obviate the necessity of deficit countries, the United States especially, to resort to such defensive policies as aid tying. There may also be a need in this connection, as will be noted below, for the more advanced countries to reconsider some of their policies of export promotion.

According to the Chairman of the DAC: 'There cannot be said to have been any appreciable progress towards more liberality in aid tying during recent years.[11] Given the pressing needs of the LDCs and the present uncertainties concerning international monetary reform, it may consequently be more fruitful at this stage to deal with the problem piecemeal by seeking to develop a series of individual measures, all with the same purpose of adding flexibility to and reducing the costs of aid procurement to the LDCs.

Surplus commodity aid

Mention has been made in our earlier discussion of the substantial aid transfers of surplus agricultural commodities by the United States especially in connection with its Public Law 480 programmes. The humanitarian aspects of these programmes are certainly laudable in their goals to ameliorate famine and other emergency conditions and in helping to raise consumption standards in many developing countries. The sales of surplus commodities for local currencies under Title I of Public Law 480 have also provided substantial programme-finance benefits to the recipient countries by enabling them to divert scarce foreign exchange to capital-goods imports, to help control inflation, and in some cases to utilize the surplus commodities in conjunction with the expansion of domestic investment.

There have, however, been certain negative influences arising from these programmes in particular instances. Thus, sales for local currency of wheat especially may have caused some trade diversion to the disadvantage of competing exporters, among which were such developing countries as Argentina and the rice exporters of south-east Asia. Also, local currency sales may have depressed the domestic price structure of competing crops, thereby creating disincentives to increases in production and productivity in the recipient country. These disincentives may have been exacerbated, finally, if continued reliance on surplus-commodity imports resulted in the diversion of government policies in the recipient countries away from needed improvements in their agricultural sector.

It is especially noteworthy that in recent years there have been substantial increases in the world demand for grains and a definite trend in United States domestic agricultural policy towards lower price supports which has resulted in significant reductions in surplus stocks. The demand for imported foodstuffs will no doubt continue to increase in the future in LDCs which are experiencing difficulties in expanding domestic agricultural output. There may also be a large potential demand intermittently particularly in the centrally planned economies as a result of vagaries in production due to unfavourable weather conditions. If such increases in demand come at a time when there are relatively poor crops in some of the important LDC producing countries, the resulting squeeze might threaten the continuity of this type of aid. It deserves mention, furthermore, that the United States has amended its Public Law 480 programme to reduce Title I sales for local currencies in favour of new Title IV arrangements which provide for dollar sales. Finally, we can take note of the World Grains Agreement negotiated in mid-1967, during the Kennedy Round, which will involve an annual contribution by the industrialized countries in kind or currency equivalent of 4·5 million tons of wheat to a multilateral food-aid programme.

When we consider the implications of all the foregoing considerations, there are two that stand out especially. The first involves the increasing reliance of many LDCs on imported foodstuffs. This is an issue which must on the whole be dealt with in these countries through programmes aimed at stimulating domestic agricultural output and restraining the rate of population growth. Such programmes take of course a long time to implement, which means that the dependency of many countries on food imports is likely to continue.

The second implication is whether the LDCs will be able to satisfy their food import needs without a substantial drain on their foreign-exchange resources in view of the changes noted in the potential availability of surplus foodstuffs and in the switch from local currency to dollar sales on the part of the United States. The switch to dollar sales means that the grant equivalent of the United States food-aid programme will be reduced and the potential debt-servicing needs of the LDCs increased. It may be, however, that the new multilateral food-aid arrangements will compensate for this change. The possibility of relatively large transitory increases in commercial demands for imports due to crop fluctuations must still be reckoned with by the LDCs, however. Such occurrences might be alleviated by stockpiling in the LDCs themselves or by means of special financial arrangements extended by the donor countries for LDC imports.

Loan terms, suppliers' credits, and problems of debt servicing

The adoption by the DAC in July 1965 of the Recommendation on Financial Terms and Conditions marked an important departure in the aid field by establishing numerical targets for aid terms against which the performances of DAC members could be compared.[12] According to the *1967 Review* (p. 81), in 1966 seven of the fifteen DAC members met the grant test (Australia, Norway, Belgium, France, Canada, Netherlands, and Sweden); the United States and

United Kingdom complied with two of the alternative provisions; Denmark and Germany complied with one of the alternative provisions; and Japan, Portugal, Austria, and Italy did not comply with any of the provisions.

An issue connected closely with that of the average loan terms is the substantial variation which exists in these terms among the various DAC members. This applies not only to official aid commitments but to an even greater extent to both government guaranteed and private non-guaranteed export-credit financing (i.e., suppliers' credits). Thus, it was bearing in mind the significant disparities that exist both in general and with respect to particular recipient countries that the aforementioned recommendation called upon DAC members to harmonize and to soften their terms of assistance where appropriate. The importance of this recommendation lies in the possibility that, if significant disparities are permitted to exist, the spectacle of the harder terms elsewhere may make it difficult for some countries to soften further or perhaps even to maintain existing terms. Moreover, inequities may be created if the hard terms of some donors pre-empt the debt servicing capacity of recipients at the expense of other donors that have provided assistance on soft terms.

This last point may indeed be the crux of the matter of the debt-servicing problems of many LDCs, especially as far as terms of suppliers' credits are concerned. Thus, it is apparent that the debt-service liabilities on guaranteed private export credits are quite substantial for a number of LDCs. This has been due mainly to the rapid growth in credits of more than five years' duration as the industrialized countries have tried to outdo one another in liberalizing credit terms in order to expand their exports and obtain footholds in the markets of many LDCs.[13] It may not be an exaggeration therefore to state that the need in many cases for softer terms on public assistance is to help offset the hard terms that many developing countries must pay on their suppliers' credits.

The statement just made should by no means be construed to denigrate the important role of suppliers' credits in the financing of trade. Nor should this statement be taken as a rationalization which is intended to overlook the mistakes in economic policy in some LDCs that may result in financial crises. The situation is one nevertheless that the LDCs cannot cope adequately with themselves given their pressing needs for capital and their inability to foresee clearly future debt problems or to exercise effective restraint over vested interests, both domestic and foreign.

As far as the donors are concerned, they should consider that they may all be engaged in a game that nobody wins on balance, although private interests may gain when suppliers' credits are converted into public assistance as part of a debt re-scheduling exercise. The time may be at hand therefore to call for restraint among donor countries in extending suppliers' credits to countries that are already over-burdened with debt.[14] Serious attention should also be directed within the donor countries themselves to obtaining more effective co-ordination of the activities of their development-lending and export-credit institutions and thus to reduce the inconsistencies in policies and practices which presently exist.

All debt-servicing problems are by no means associated with substantial accumulation of suppliers' credits, however, for there are some LDCs (e.g., India and Turkey) in which debt-servicing problems stem in large measure from their accumulated official development-assistance liabilities. In these cases the problems are due more generally to the structural inadequacies of long-run savings and foreign-exchange earnings.[15] The consideration of debt rescheduling should be made to accord therefore with the long-run development criteria that may be most appropriate in these cases for the fulfilment of their assistance needs.

II. THE CENTRALLY PLANNED ECONOMIES

Aid provided by the centrally planned economies is characteristically bilateral. It is designed to finance projects and is tied to procurement in the source country. It is common for repayments to be made in kind in the form of the recipient's traditional export goods or occasionally through the export of goods produced from the aid-financed project itself. The foreign-exchange problems of debt servicing familiar in relationships with the developed market economies thus do not arise directly. A further noteworthy feature of the aid activities of the centrally planned economies is the extent to which their assistance embraces all phases of the development of projects through to their final completion. This includes the provision of technical services and the training of local personnel to work on and subsequently to take over the operation of the completed projects. Such practices, if successful, may avoid some of the undesirable effects that utilization of suppliers' credits has provided on occasion in individual recipient countries.

Reliance on the reciprocal tying of aid stems from the concept of 'mutual benefits' which is a principle associated with the aid programmes of the centrally planned economies.[16] This principle has worked out in actuality to encompass both the economic and political benefits that may accrue to the donor and recipient, although the sharing of the benefits may not be symmetrical. The tying of aid to procurement in the source country has been necessitated by the need to marshal limited supplies of foreign exchange to obtain essential imports. Thus, in this light there would be no aid at all unless it were tied. Aside from foreign-exchange problems, the reason for tying aid on a bilateral basis has been the lack until recently of the convertibility of the currencies of the individual Bloc economies *vis-à-vis* one another. It may be mentioned finally that the practices of tying have been consonant with the physical planning orientation of the donor countries.

The emphasis on bilateralism, project assistance, and the tying of aid would seem to have the same drawbacks mentioned in our earlier discussion, except perhaps for the debt-servicing characteristics which have been noted. There is nevertheless an important degree of uncertainty present in the real loan terms. This arises from the fact that the prices of the aid goods and services and of the goods designated for repayment are based on current world-market prices at the time the aid agreement is negotiated. While these agreements contain safeguards against general inflation and devaluation, they do not offer any guarantee against changes in world prices. The consequence is that if substantial price fluctuations occur, the effect could be to alter significantly the real cost of the loan to both parties. Once this is recognized, the advantage of reciprocal tying becomes somewhat less certain unless there are other compensating factors involved such as those discussed above. This would suggest that it might be fruitful to explore other financing arrangements for repayment that could be operated more flexibly. Such arrangements might now be more feasible than formerly in view of the multilateral-payments balancing that may become more widely used among the centrally planned economies.

The question of the terms of aid of the centrally planned economies also deserves brief comment in connection with the previously discussed debt-servicing problems of some developing countries on account of their outstanding official loan liabilities. The point at issue here is that it is immaterial whether debts are serviced in kind or in foreign exchange. For in both cases, it is clear that the real budgetary cost of debt servicing may be equally burdensome. The centrally planned and the developed market economies thus have a joint interest in debt rescheduling in instances where debt servicing has risen to the point where the development effort is threatened with interruption and retardation.

III. MULTILATERAL INSTITUTIONS

As mentioned earlier, the influences of the multilateral institutions go far beyond merely the recorded magnitudes of their lending and related activities. What is noteworthy in recent years is that their policies and practices have continued to evolve in the light of changing conditions in both donor and recipient countries, and that they have been in the forefront of new departures in the field of assistance.

The world bank

Project financing has long been and will continue to be the main business of the World Bank. However, as the need for additional programme assistance has become increasingly clear, the Bank has allocated a larger amount of its resources for this purpose in particular recipient countries. There are also indications of a greater willingness to finance some proportion of the local costs of projects when the recipient evidently cannot shoulder the entire task. With the coming into existence of the International Development Association (IDA), the Bank has acquired much greater flexibility in establishing the terms of lending by being able to provide funds on blended Bank and IDA terms. Bank influence on the terms of lending has been evidenced further in the joint-financing ventures which it has undertaken in co-operation with donor countries. Finally, the Bank's activities in promoting aid consortia and consultative groups have already borne important results both in increasing the flow of assistance and seeking its more effective utilization.

One of the long established policies of Bank lending has been to direct its financing by means of international competitive bidding to the cheapest sources of supply. Bank financing tied to particular source countries has therefore been ruled out of consideration. While this is a policy with which there can hardly be any quarrel, it has become increasingly clear that the Bank may have to adapt its policy in the light of the conditions which donor countries, the United States in particular, may attach on balance-of-payments grounds to a replenishment and expansion of IDA resources. If it turns out in fact that future pledges to multilateral agencies will contain tying conditions, it will then be imperative for the Bank to develop machinery to administer these pledges so that the excess costs of tying to the recipient countries will be kept at a minimum.[17] By the same token, the Bank might possibly devise ways to exert its influence on aid tying generally to achieve the end just mentioned.

Regional development banks

Another recent innovation which promises to become increasingly important is the organization of regional development banks. The Inter-American Development Bank, which has been in operation since 1960, has already had a significant impact on most aspects of development assistance in Latin America. While the difficulties faced by the Asian and African Development Banks will perhaps yield less readily to solution since the member countries are not as highly developed as those in Latin America, the influence of these banks will nevertheless be important.

The operating characteristics and problems of the regional development banks will in many, but not all, ways parallel those of the World Bank. These banks can therefore profit greatly from World Bank experience and advice. But in catering to the special needs and problems of their regions, they may be able to fulfill a role which otherwise would have gone unplayed. This may involve not only lending activities which cut across national lines, but also activities which will foster the closer integration of these economies. The regional development banks may thus raise problems of aid terms and debt servicing which have a different order of dimension than the more familiar ones which have been considered to date.

Debt servicing and rescheduling

Brief mention may be made finally of the activities of the International Monetary Fund (IMF) and such *ad hoc* entities as the 'Hague', 'Paris' and other creditors' 'clubs' in their concern with debt servicing and debt renegotiation. The majority of these activities has thus been in connection with LDCs that have run into serious balance-of-payments difficulties as a consequence often of lax and improper domestic-economic policies and an associated accumulation of short and medium-term commercial credits which have come due all at once. It has been common practice to approach each case of debt rescheduling on an *ad hoc* basis with fairly short terms and to place great emphasis on the need for domestic reforms to prevent another crisis from occurring. This approach can be defended on the grounds that it is important to avoid creating any presumption that debt rescheduling is something that a recipient country can take for granted.

There is of course much to be said for the view just stated. What may be overlooked, however, is the point mentioned earlier concerning the contribution to the crisis which the more advanced countries may have furnished, especially by their competition in export credits. Some more systematic checks upon the export-credit activities of the more advanced countries may thus help to nip future crises in the bud. The IMF can certainly perform a useful service in this respect through their annual reviews. It may also be fitting in addition to reiterate in the present context the need for more systematic review of cases of impending debt-service problems arising from long-term public assistance loans.

IV. RECIPIENT COUNTRIES

The discussion would not be complete without a few words concerning the effective utilization of development assistance by the recipient countries. Many recipient countries have unfortunately not yet reached the point of being able to cope adequately with the somewhat bewildering array of national, international, and private institutions and mechanisms through which development assistance flows. The problems of recipients are often exacerbated furthermore by the lack of co-ordination among the individual sectors which carry on more or less independent activities involving development finance.

As a consequence of these deficiencies in administration, it is possible that in many countries the costs of assistance may be higher than they would otherwise be. This may be true particularly where tied aid and suppliers' credits are involved and the recipient has not had or taken the opportunity to shop around. Also, the allocation of assistance within the economy may be less efficient as new investment is expanded more in some sectors than in others without adequate consideration of alternative rates of return.

What is required in recipient countries under the circumstances described may be the centralization of responsibility for handling all of the aspects of development finance. It would be possible in this way to build up a staff of trained personnel in each country that would acquire the expertise which is necessary to analyse the various aid offers, negotiate financial terms, provide the link between foreign and domestic-credit institutions, and so on. Some recipient countries have already achieved considerable sophistication in these matters and their experiences and organizations might be studied fruitfully by others. This is also an area of activity in which technical assistance provided particularly through the World Bank and regional development banks could be of great value.

V. NEW DIRECTIONS IN DEVELOPMENT ASSISTANCE POLICIES

It is clear from the survey just completed that there are many difficult problems arising out of existing development assistance policies and practices. Perhaps the most pressing are the problems associated with aid tying, competition among the more advanced countries in the extension of suppliers' credits, and debt rescheduling. Some possibilities for alleviation of these problems have already been suggested or implied in the preceding discussion. It may be useful, however, to spell out these possibilities in somewhat greater detail.

Tied aid

The unilateral reduction of aid tying is a step which donor countries are reluctant to take under present international financial conditions.

This is understandable for countries with balance-of-payments deficits like the United States since unilateral untying might make the deficit larger. But there is no reason why unilateral untying could not be carried out by surplus countries. Of course, such a policy would probably not have immediate effects because of lags in the commitment and disbursement of aid. It is likely, moreover, that since the international competitive position of the deficit country may have deteriorated through time, that country would be forced as part of its balance of payments adjustment to institute measures to improve its position. The point of the unilateral action by the surplus country is therefore to build the effects of untying into the balance of payments adjustment process. Once the country with the initial deficit has moved into equilibrium or into a surplus position, it could then reciprocate the untying action. Aid tying would thus be eliminated gradually provided that the more advanced countries agreed that they would not reinstitute it in the event of future deficits.

Multilateral untying might be considered as an alternative to unilateral untying. But to make it acceptable to deficit countries, it would be necessary to ask the surplus countries to assume a greater share of the commitments. Following the precedent set in the DAC Recommendation on Financial Terms and Conditions, consideration might be given to establishing numerical targets for untying which took into account the balance-of-payments positions of the member countries. This would have the advantages noted above plus providing a standard against which member country performance could be compared.

If it turns out that movement along the foregoing lines is either not feasible or that it would work too slowly, the next best approach would be to seek a series of partial measures, all of which would be designed to operate in the direction of minimizing the excess costs of tying. Such measures might include: (1) subjecting bilateral flows to multilateral review through the activities and organs of the World Bank and the regional development banks; (2) improvements in donor-country aid practices; (3) multilateral purchasing arrangements; and (4) more effective utilization of aid resources in recipient countries.

1. *Multilateralizing influences*

There are already ways in existence by which the World Bank and the regional development banks could further promote a multilateralizing influence on bilateral flows. One of these is through the review process of aid consortia and consultative groups in which the immediate and planned future assistance needs of the recipient countries are topics for discussion among all the interested parties. Another possibility is through a more widespread use of joint-financing ventures which align the skill and reputation in project analysis and the financial resources of the multilateral institutions with those of individual donor countries. A third way would be to provide some type of international project-costing service that could assist developing countries even when a project was to be financed bilaterally.

It was mentioned above that it is likely that increasing pressure may be brought to bear upon the World Bank especially to alter its longstanding policy against restricted aid commitments. This will be the case if balance-of-payments considerations continue to have a direct bearing upon the foreign-aid programme of the United States, the single largest donor. As noted, the question of aid tying has come up already in connection with the proposed replenishment of IDA resources. Since it would be undesirable and even inequitable to excuse a donor country from its aid commitments on balance-of-payments grounds, aid tying might therefore have to be condoned.

The problem then would be to utilize this tied procurement in order to minimize its inconvenience and the impact of its higher costs on recipient countries. This will be more easily accomplished the more co-operative the donor is in providing a broad list of commodities and services for aid purposes. Since the World Bank would still presumably subject all of its projects to international competitive bidding, it would be in a good position to adjust the volume and terms of its overall resources, including those that were tied, to approximate as closely as possible the cheapest available supply prices for the given investment. This would admittedly be more cumbersome than its regular practices, but there may be no way to avoid it under present balance-of-payments circumstances.

2. *Improvements in donor-country aid practices*

From the standpoint of the donor countries themselves, there are a number of possible measures that they could undertake individually. In cases where it is not already done, administrative procedures could be instituted to oversee the placement of bids domestically and to take steps to assure competitive prices of aid-financed goods. As was mentioned earlier, the question here is not only one of the donor's price quotations being relatively high because of the loss of international competitiveness. Such quotations may be high also because there is a lack of competitiveness in the domestic economy as well and the suppliers in question are able to increase their prices without fear of losing the sale which is to be tied in any case. Assuming that the recipient has no other alternatives, this double tying might therefore impose on it a substantial burden unless the donor country were to take corrective action.

The corrective action of the donor in this case might involve requesting its suppliers to lower their bids to internationally competitive levels, or the donor could adjust the composition of its aid in order to permit a wider choice of goods at competitive prices. If neither of these alternatives was feasible, the donor might be requested to consider releasing the aid funds in question to less costly supply sources in other more advanced countries. However, this might create the problem mentioned earlier concerning the extent to which these other countries would use the increase in foreign exchange to expand imports or to augment their international reserves. The more that particular countries trade normally with one another, the less net drain there might be on the donor's balance of payments. It is possible under these circumstances therefore that the donor might specify certain other supplying countries in which procurement would be permitted when warranted by cost considerations. If these other countries also happened to be in balance-of-payments deficit, an action of this kind could be equilibrating, although it might possibly be objected to on the grounds that it was discriminatory in nature.

Corrective action by the donor could also be taken by making a special grant to the recipient in order to absorb the excess costs due to tying. Or consideration could be given, following the practice of the centrally planned economies and the associated UNCTAD Recommendation A. IV. 4, to tie loan repayments to goods produced in the recipient country. The advantage of a special grant would be to insure that the nominal and real value of the resources made available to the recipient were equivalent. Reverse tying would help to ease the transfer problem of loan repayments. But it is not clear whether the recipient would be relieved of the extra costs of tied aid unless the goods specified for repayment in kind were valued at higher than commercial levels. This might have an important drawback from the donor's standpoint, however, if import of the goods in question displaced domestic production, as could be the case with simple manufactures.

There is also the problem noted earlier that projects financed with tied aid may turn out to be relatively inefficient. Thus, even though a part of the recipient's production was earmarked for repayment purposes, possibly at more favourable than existing market terms, this would only be a partial offset to the inefficiency involved in the project as a whole. It would thus be most desirable if the recipient were able to utilize aid to finance its projects at minimum costs and to realize income both at home and abroad through the sale of efficiently produced goods and services. A special grant to compensate for the excess costs of tying would thus be preferable to reverse tying if it permitted the excess costs in question to be written off.

3. *Multilateral purchasing arrangements*

A logical extension of the release procedure mentioned in the preceding section might be to develop triangular arrangements in which the donor would specify that its aid be used for procurement in another presumably low-cost country against an equivalent amount of purchases by this other country in the donor's market. The main difficulty with this idea is that it would present the same kind of problem as in direct tying. That is, if the triangular arrangement resulted in the other country switching some of its regular imports from the donor to a different supply source, the donor's balance of payments would be affected adversely to some extent.

An alternative which is similar in principle to the triangular arrangement would be for a donor that was a member of a regional economic grouping to permit the recipient to use the donor's assistance in whatever one or more of the other member countries that happened to be the cheapest source of supply.[18] Such a proposal would work best if the comparative cost structures differed significantly among the member countries themselves, and especially if they carried on a major part of their trade with one another and followed common policies, including multilateral payments balancing at least within the regional grouping.

Of the two major groupings comprising donor countries, the conditions favourable to multilateral purchasing arrangements would appear to be approximated more closely by the Council of Mutual Economic Assistance (COMECON) rather than by the European Economic Community (EEC). This is because the EEC members carry on a substantial part of their trade with outside countries. The EEC members also do not follow as yet completely uniform domestic and international economic policies. In view of these considerations and the fact that they require payments imbalances to be settled mainly in dollars and gold, multilateral purchasing arrangements could result in undesired balance-of-payments effects both within the EEC itself and with respect to outside countries.

In exploring the feasibility of multilateral purchasing arrangements within COMECON, consideration might also be given more generally to multilateral balancing *vis-à-vis* individual LDCs. These arrangements could conceivably be broadened to permit greater flexibility in the spending by LDCs of bilateral balances within COMECON and by COMECON members within particular LDCs.

4. More effective utilization of aid by recipients

It is obviously in their own interest for the recipient countries to allocate their foreign-exchange and foreign-assistance resources as efficiently as possible. This is not only a question of the careful preparation and implementation of projects, but also one of co-ordination among the various sectors and institutions concerned with development and its financing in each country. The more successful the recipients are in locating the cheapest sources of supply for the financing of their development needs, the better off they will be. Such success may admittedly make the aid-tying arrangements of the donor countries more difficult to administer on account of the substitutions which the recipients may arrange in their imports both as to composition and source. This process should be looked upon, however, as a balancing rather than a conflict of interests between recipient and donor. It will therefore require both co-operation and understanding.

Suppliers' credits

The problems created by the increased reliance on suppliers' credits by many LDCs must be recognized to be the joint responsibility of these countries themselves, the more advanced countries, and the appropriate multilateral institutions. It is difficult to formulate general principles to deal with these problems because of the wide variations in individual circumstances which exist in both lending and borrowing countries. There is agreement nevertheless on the desirability in general for LDCs to set realistic limits on the amount of credit which they can hope to service when the time comes, for the more advanced countries to co-operate in the exchange of information and jointly to establish norms for credit terms and amounts to suit the debt position and needs of individual borrowing countries, and for the multilateral institutions, the World Bank and IMF in particular, to keep continually in touch with all parties concerned and to use their influence in dealing with problems as they may arise.

The annual IMF consultations and the periodic meetings of the various aid consortia and consultative groups should serve to keep these matters under continual review. More concretely, the possibilities should be explored of a more systematic linking of World Bank financing with that of equipment credits which are largely a national affair at present. The Bank's expertise in project evaluation and knowledge of individual country needs would be brought to bear upon the technical suitability and credit terms on which the equipment was to be financed. This combination of Bank finance and equipment credits, which normally are government guaranteed, would be advantageous moreover to the extent that it enhanced the marketability of the securities underwritten for the given financing.

Debt rescheduling

The question of debt rescheduling is also one that is best dealt with in the context of the situation facing individual countries. As was mentioned earlier, most of the cases of debt rescheduling have been handled thus far on an *ad hoc* basis. However, since the debt-servicing problems of a number of borrowing countries are becoming increasingly apparent,[19] it might be worthwhile to determine if any criteria can be formulated by the lending countries which will be helpful in coping with these problems. Consideration of criteria might include a review of the reschedulings that have taken place in recent years, both as to overall terms and the distribution of the sharing of burdens by individual lending countries. It might also be fruitful to carry out some theoretical exercises under assumed conditions in order to examine the impact of various kinds of rescheduling, especially when the problem is one of servicing long-run liabilities rather than one of dealing with the excessive accumulation of short and medium-term obligations.

There is in addition apparently a need for earlier identification of impending problems and communication among the interested parties. This is an area again in which the aforementioned groups and periodic consultations can be helpful. The IMF in particular could play an important role in furthering the development of an advance warning system that would bring problems to the attention of the lending countries before a crisis stage is reached.

VI. CONCLUSION

The suggestions just made may no doubt appear to be anticlimatic and possibly open to the criticisms that they are unrealistic and in any case will not accomplish very much. It can be argued therefore that what is of the utmost importance is to keep attention focused on the most pressing issue of all, which is to increase the volume of assistance to the LDCs. Thus, the advanced countries should be badgered about their having continually fallen short of the one per cent aid target (based on GNP) and that they should take measures to soften their terms of aid. These countries can be urged, moreover, to channel more of their assistance through multilateral institutions and to give serious consideration to new financing arrangements such as the Horowitz proposal for interest-rate subsidies and the World Bank scheme for supplementary financing.[20] These are laudable objectives, of course, given the pressing needs of the LDCs for capital assistance and import financing and the impending seriousness of debt-servicing problems in many countries.

The fact remains nevertheless that the donor countries have shown little or no inclination in recent years towards increasing substantially the volume of aid flows to the LDCs. This head-in-the-sand attitude on the part of the donor countries is to be deplored. Hopefully, with the settlement of the Vietnam conflict and the calming down and eventual reform of the international monetary system,[21] the attitude towards increased aid flows may become more favourable. There is no guarantee that this will happen, however, particularly if countries like the United States become preoccupied in trying to resolve their own domestic problems. In such an event, it will become imperative to seek greater efficiency in both donor and recipient countries as far as aid giving and utilization are concerned. This is admittedly not a very dramatic prospect, but it may represent the only real choice open in the immediate future.

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Notes and references

1 For further details, see Organization for Economic Cooperation and Development (OECD) *Development Assistance Efforts and Policies of the Members of the Development Assistance Committee, 1967 Review* (September 1967) p. 13.

2 For a comprehensive review of the main issues involved here, see Jagdish N. Bhagwati *The Tying of Aid* UNCTAD, TD/7/Supp. 4 (1 November 1967).

3 OECD *Development Assistance Efforts and Policies, 1965 Review* p. 90. It is noteworthy that this estimate is substantially greater than is implied by the estimates for individual DAC members given in OECD, *The Flow of Financial Resources to Less-Developed Countries, 1961–1965* (Paris 1967) p. 113.

4 Bhagwati *op. cit.* p. 45.

5 Bhagwati *op cit.* p. 48.

6 Bhagwati *op. cit.* p. 33.

7 Mahbub Ul Haq, 'Tied Credits – A Quantitative Analysis', in John H. Adler (ed.), *Capital Movements and Economic Development* (New York 1967) pp. 331–2. Bhagwati *op. cit.* p. 35 has argued that Ul Haq's estimate may be too low because insufficient account has been taken of the possibility of monopolistic pricing of aid-financed goods by donor countries and limited substitution possibilities among supplying countries.

8 Eprime Eshag *Study of the Excess Cost of Tied Economic Aid Given to Iran in 1966/67* UNCTAD, TD/7/Supp. 8/Add. 2 (13 December 1967).

9 See John Pincus *Costs and Benefits of Aid: An Empirical Analysis* UNCTAD, TD/7/Supp. 10 (26 October 1967), for some calculations of the reductions in the real amounts of aid transfers to the LDCs on account of tying. For example, assuming a 12 per cent discount rate, taken to represent the marginal rate of return to domestic investment in the LDCs as a group, and a rate of excess cost on aid tying equal to 15 per cent, Pincus estimated (p. 35) that the 'grant equivalent' of the official borrowing commitments of 39 LDCs (for which World Bank data exist) was only 31·6 per cent of the nominal value in 1964 and 32·3 per cent in 1965.

10 For example, if the tying of aid were to involve an excess cost of the project equal to 50 per cent over world market prices, this would more than offset the transfer contained in a ten-year, interest-free loan repayable in full at maturity and discounted at a 4 per cent alternative cost of capital, or a fifteen-year, interest-free installment loan discounted at 5 per cent. See Harry G. Johnson *Economic Policies Toward Less-Developed Countries* (Washington 1967) p. 81.

11 OECD *Development Assistance Efforts and Policies, 1967 Review* p. 87.

12 According to OECD *op. cit.* p. 80, the targets were 'that DAC Members should either:
(*a*) provide 70 per cent or more of their commitments in the form of grants; *or*
(*b*) (i) provide 81 per cent of total commitments as grants or loans at 3 per cent interest charges or less;
(ii) provide 82 per cent of total commitments as grants or loans with repayment periods of 25 years or more;
(iii) attain a weighted average grace period of 7 years.'

13 Discussion of the policies and problems arising with suppliers' credits can be found in World Bank *Suppliers' Credits from Industrialized to Developing Countries* (Washington 1967), and United Nations *Export Credits and Development Financing* 67.II.D.1 (New York 1967).

14 The situation with respect to suppliers' credits has been described in The World Bank and IDA *Annual Report, 1966/67* p. 32, as follows: '. . . on the whole, suppliers' credits have played a useful role in development finance, enabling creditors to increase exports of equipment and providing debtors an additional source of finance for investments. In some countries, however, their excessive use has led to unduly high debt-service payments because of maturities considerably shorter than warranted by the country's position. The ready availability of such credits has sometimes encouraged the diversion of scarce resources into low priority projects. In a few extreme cases, the burden of servicing such debt has contributed to financial crises which have required rescheduling operations (e.g., Ghana and Indonesia in 1966; Argentina, Brazil, Chile and Turkey in previous years). Some debt crises have had adverse effects on the credit-worthiness of the countries concerned and thus on their access to foreign finance. The assumption of excessive credits has not been the sole responsibility of the debtor countries; export promotion among creditor countries has often led to the provision of excessive amounts of such credit on terms inconsistent with the debt-servicing capacity of the debtor countries.'

15 See IDA *op. cit.* p. 31.

16 For a discussion of this principle, see United Nations *World Economic Survey* 1965 (New York 1966) ch. IV.

17 According to a World Bank release dated 18 January 1968, the proposed amount of IDA replenishment has been set at $1,200 million, payable in three annual instalments of $400 million each to begin in the fiscal year ending 30 June 1969. It is envisaged that the IDA policy of obtaining competitive international tenders will be continued. But in view of the United States balance-of-payments difficulties, IDA will call only that

portion of the United States contribution required to finance procurement in the United States. If this proposal is accepted, it will be interesting to see whether the World Bank will in fact call the entire United States contribution, even though it is on a tied basis.

18 A rather different alternative might be for the donor to direct his aid in order to foster the integrated development of a number of recipient countries, all of whom had high feedback ratios in their trade *vis-à-vis* the donor. Such a policy would evidently have a goal other than that of obtaining the cheapest supply prices since some margin of protection might be required to make it effective. It is conceivable nevertheless that this protection might justify itself in the long run.

19 Projections of debt service for 1970 and 1975 are to be found in UNCTAD *The Outlook for Debt Service: Report by the UNCTAD Secretariat* TD/7/Supp. 5 (31 October 1967).

20 The Horowitz proposal envisages an organization like the World Bank floating issues at commercial rates in private capital markets and making these funds available to the LDCs on essentially IDA terms. The interest subsidy involved would then be met through donor-country contributions to the IDA. For additional discussion, see UNCTAD *The Horowitz Proposal: Study by the UNCTAD Secretariat* TD/7/Supp. 11 (6 December 1967).

The World Bank scheme for supplementary financing is designed to deal with problems arising from unforeseen export shortfalls which cannot be adequately dealt with by short-term balance-of-payments measures and which threaten to disrupt development programs. For a balanced evaluation of this scheme, see UNCTAD *Supplementary Financial Measures: Final Report of the Intergovernmental Group on Supplementary Financing as adopted by the Group at its third session held at Geneva from 30 October to 13 November 1967* TD/33 (16 November 1967).

21 The big question at the moment is whether and when the new plan for Special Drawings Rights (SDR) will be implemented. It should be emphasized that creation of SDR is intended primarily to ensure an adequate growth of reserves over time for both the industrial countries and the LDCs. The LDCs will receive the SDR in proportion to their IMF quotas, which should lessen to some extent the seriousness of balance-of-payments constraints upon their development. The assurance of adequate reserves in the industrial countries will also be of benefit to the LDCs insofar as rapid expansion is sustained in the level of world trade and there is no necessity to resort to ad hoc balance-of-payments restrictions which affect development aid. It is conceivable of course that the creation of SDR could be linked organically with the provision of additional development aid. But it is doubtful that this is what the industrial countries have in mind. International monetary reform through the activation of the plan for SDR is not likely therefore to lead to an immediate and large increase in the flow of development aid to the LDCs.

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