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September 23, 1964 - E. P. Wright
Speech - Los Angeles, Calif.

FINANCIAL MANAGEMENT IN A GLOBAL ECONOMY

Role of the International Consortium

The Marshall Plan, which was so vital to the post-war recovery of Europe, was an example of a single country -- the United States -- extending economic aid to a large number of recipients who worked together in framing their requirements and coordinating their policies. Out of this grew the Organization for European Economic Cooperation, now the Organization for Economic Cooperation and Development.

This is, however, the only case in the post-war world where a group of countries receiving aid has cooperated effectively in the implementation of a joint aid program. The Colombo Plan for South Asia, which was launched in 1950, was conceived in similar terms, but in practice no comparable working relationship has developed between its members.

Few of the European countries which took part in the Marshall Plan continue to receive any large amounts of aid. Most of them have themselves become aid donors and, along with the United States and Canada, are now responsible for most of the international aid extended outside the Soviet bloc and China.

There is some dispute as to what can be properly called "aid", but on most accepted definitions the flow of international aid, excluding strictly military aid, is now in the range of \$6-7 billion annually. Two thirds of this is from the United States and most of the rest from France, the United Kingdom, Germany, Japan and Canada -- in that order.

Other countries outside the Soviet bloc which are extending economic aid on a smaller scale are Italy, Switzerland, the Netherlands, Belgium, Austria, the Scandinavian countries, Australia and New Zealand. To these in recent years has been added Kuwait, which is lending on quite

favourable terms to some of the neighbouring Arab states.

A few of the so-called underdeveloped countries are also extending aid -- for example, India to Nepal and Egypt to Algeria -- but what these countries give is very much less than they receive.

In relation to national income France extends more aid than any other country, and most of it in the form of grants rather than loans. French aid is, however, largely concentrated in the former French territories. British aid likewise tends to be extended mainly to members of the Commonwealth. The United States' aid program is more widely dispersed and can fairly be described as global.

As the number of aid-giving countries has increased, there has been felt a need for their activities to be coordinated, particularly in the more important of the developing countries, some of which may be receiving aid from as many as twenty or more governments and international agencies. While the primary responsibility for coordination rests with the recipient country, the donor countries also have come to see an advantage in concerting their aid efforts.

The idea of an international consortium has been developed in response to this need. So far, however, it has been applied very selectively.

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Strictly speaking, in the commonly accepted jargon, there are only four such groups which are called consortia. Two of them have been organized under the leadership of the World Bank, one for India and one for Pakistan; and two have been organized under the OECD, one for Turkey and one for Greece. Comparable -- but in certain respects quite different -- associations of donors have been formed by the World Bank for certain other countries,

namely Colombia, Nigeria, Sudan and Tunisia. These have become known as "consultative groups".

The essential difference between a consortium and a consultative group -- as the term is understood by the Bank -- is that a consortium is expected to come up from time to time with specific pledges of aid which are then publicly announced. Consultative groups on the other hand have been formed on the understanding that no such pledges will be called for.

In certain respects, however, the coordination of lending activities is closer in the case of the consultative groups than the consortia. This is because in countries like Colombia and the Sudan the number of development projects and programs eligible for external financing is comparatively small, and it has been practicable for the Bank itself to examine most of these projects and to indicate which it considers suitable for financing by other members of the group. The "project list" has thus become the principal instrument of coordination. In India, on the other hand -- and to some extent in Pakistan -- there are too many projects and programs for the Bank to be able to acquaint itself with all of them in any detail and thus be in a position to make specific recommendations to other consortium members.

The Bank has taken the view that consortia and consultative groups can only be justified for countries whose development programs and economic policies are soundly conceived, and where the technical, administrative and managerial resources exist to implement the programs decided upon. Another condition which has to be fulfilled before a consortium can be formed is that there should be a sufficient number of the Bank's member countries interested in extending financial assistance to the country in question.

The Indian consortium has ten members in addition to the Bank and the International Development Association. These are the United States, Britain, Germany, Japan and Canada, who were the five founder members when

the consortium started in 1958, and also France, Italy, the Netherlands, Belgium and Austria. The same countries with the exception of Austria belong to the Pakistan consortium.

The consultative group for Colombia includes twelve member countries plus the World Bank and the International Development Association -- and also plus the Inter-American Development Bank. About ten countries attend the meetings of the consultative groups for Nigeria, Sudan and Tunisia. The International Monetary Fund, incidentally, though not a member, sends an observer to all meetings of consortia and consultative groups.

It is perhaps worth noting in passing that India and Pakistan are in a class apart from all the other underdeveloped countries to which the Bank is at present lending both with respect to the size and poverty of their populations on the one hand and the magnitude of their aid requirements on the other. India alone, with 470 million people, has a population roughly equal in size to the combined populations of all the 60 odd countries of Africa and Latin America.

This is an uncomfortable fact and explains why, although India receives more aid in absolute terms than any other developing country, it receives only about half as much per capita as the average for all the underdeveloped world. It is hardly surprising therefore that other countries have complained about India getting too much aid, whereas the Indians are apt to feel that they are getting too little.

Pakistan, with a population now about 110 million, though much smaller than India, is twice as large as any single country in Africa. Indeed only two other underdeveloped countries outside the Soviet bloc are in the same league in terms of population. These are Indonesia -- also about 100 million -- and Brazil (75-80 million).

Indonesia, as Mr. Woods, the President of the World Bank, noted recently in Tokyo, has been debarred from borrowing from the Bank so long as it fails to offer reasonable compensation for expropriated foreign property. In Brazil the problem has been a different one. The Bank lent nearly \$300 million to Brazil in the years from 1949 to 1959. It has not lent since this because of the country's extremely heavy burden of indebtedness, its unstable internal financial position and the Government's failure to keep inflation in check -- though the economy has gone on expanding fairly steadily in spite of financial instability.

Recently, however, with the change of regime, Brazil has been re-considering its financial policies, and the Bank will be sending a large economic mission to Brazil in a few weeks time to review the situation.

From what I have said you will appreciate that the scope for extending the kind of consortium arrangement that has been established for India and Pakistan -- or even the less formal type of consultative group -- is not likely to be very great. Nevertheless, the fact that India and Pakistan alone constitute such a large part of the population of the underdeveloped world outside the Soviet bloc and China lends significance to the role of the international consortium in the business of economic development and in helping to provide markets for the exports of the United States and the other more advanced industrial countries.

I would add that Nigeria with a population of 55 million is the most populous country in Africa, while the Sudan with an area nearly four times that of Texas is the most extensive. Both these countries are among the most stable in Africa and have been making very serious efforts to push ahead with economic development.

From this point on, in trying to explain how a consortium works and what it tries to achieve, I propose to speak mainly about India. This was the first consortium to be formed, and it is, of course, the largest in terms of the amount of aid, pledges having amounted to roughly one billion dollars a year over the past four years. The comparable figure for Pakistan is between \$400 and \$450 million.

The Indian consortium -- usually referred to in India as the Aid India Club -- was called into existence in August 1958 at a time when India's Second Five-Year Plan was threatened by an acute balance of payments crisis, and there appeared to be a risk of the country running out of foreign exchange. At the first meeting of the consortium, which was presided over by Mr. Eugene Black, the World Bank, the United States, Britain, Canada, Germany and Japan agreed to lend India \$350 million to tide her over the crisis; and at a second meeting held in March 1959 roughly a further \$250 million was promised.

What started primarily as a rescue operation developed into a program of sustaining external support for India's development effort. Early in 1960 when the Indian Government was preparing the outline of its Third Plan, three eminent bankers -- Mr. Sproul from the United States, Sir Oliver Franks from Britain and Dr. Abs from Germany -- went to India at Mr. Black's request to review what the Indians were planning to do. Their report, and that of an economic mission from the Bank which visited India in the spring of 1960, concluded that the Third Plan was essentially sound in conception and provided a workable basis for continued external assistance from the West.

Both reports expressed certain reservations -- some quite sharp reservations -- about India's economic policies and planning methods, and the Bank mission questioned whether India would succeed in achieving the $5\frac{1}{2}$ percent rate of growth which she was aiming at. Indeed, they thought it unlikely that the

annual increase in output would exceed 4 percent a year. Nevertheless, these reports, which were made available to all members of the consortium, were regarded as broadly endorsing the Third Plan.

The consortium also accepted the view put forward by the Government of India and supported by the Bank mission that external assistance on a gross basis of at least \$5½ billion would be needed over the five years to see the Plan through. This \$5½ billion included an allowance of \$300 million for the inflow of new private foreign investment, that is an average of \$60 million a year.

It was also assumed that some part of India's aid requirements would be covered out of loans from countries outside the consortium, notably the Soviet Union. In fact, aid committed by the Soviet bloc for the Third Plan has amounted to about \$800 million, with a further \$10 million from Yugoslavia. Some other countries which are not members of the consortium have also helped on a smaller scale, notably Switzerland, Australia, New Zealand, Denmark and Norway.

Discussions about the financing of the Plan took place in Paris in September 1960. These were followed by further meetings of the consortium in the summer of 1961, and the end-result was that the consortium agreed in August 1961 to extend \$2,225 million of assistance to India for the first two years of the Plan (April 1961 through March 1963). As a result of further meetings held in 1962 this amount was raised to \$2,365 million.

The consortium met again twice in 1963 and twice in 1964, and in each year aid pledges totalled a little over \$1 billion, bringing the aggregate for the four years April 1961 through March 1965 to \$4,445 million.

The practice is now to hold two meetings a year, one or two months apart. At the first meeting, which is attended by senior officials of the Indian Government, the consortium reviews the progress of the Indian economy, discusses the country's economic policies and considers the statement of aid requirements presented by India. At the second meeting members announce their pledges for the coming year, which is the Indian fiscal year beginning in April.

Increasingly, as the performance of the Indian economy has lagged and there has been evidence of serious deficiencies in the implementation of the Plan, the consortium has made known to the Indian Government its concern over certain aspects of Indian policy and has pressed for more vigorous action to deal with obstacles to growth.

It has constantly emphasized, for instance, the need for more concentration on agriculture, for more energetic policies of export promotion and for measures to encourage private foreign investment. It has also hammered at the population theme, reminding the Government of India of the obvious fact that India can never break away from its present poverty unless ways can be found of curbing the growth of her population, at present increasing at an annual rate of 2½ percent -- that is, roughly 10 million more people to feed every year.

Decisions on aid to India rest, of course, with individual members of the consortium and not with the consortium as such. Each member negotiates aid independently with the Government of India on a bilateral basis.

The consortium is thus a very loose organization, if indeed it can properly be called an organization at all. In between meetings its activities are limited to a periodic exchange of information, for instance, through quarterly reports on aid agreements concluded in fulfillment of pledges made

at previous consortium meetings. The President or one of the Vice-Presidents of the World Bank presides over the consortium meetings, and the Bank staff is responsible for progress reports on the economy, for circulation of documents and so forth. But the consortium has no permanent secretariat of its own.

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What then has the consortium achieved which would not have been achieved without it? There can be no definitive answer to this question, but I will venture a few personal opinions based on the experience of the consortia for India and Pakistan.

In the first place the existence of a consortium provides some assurance that aid will continue from year to year on a fairly regular basis and will not be suddenly cut off -- barring, of course, some drastic change in the conditions or policies of the recipient country. This is important for the forward planning of development. It is also important from the point of view of foreign businessmen such as yourselves who may be trading with or considering investment in the country concerned. Business confidence in India and Pakistan has shown itself responsive to the insurance which the consortium affords against a payments default.

It is probably true to say also that, at any rate for both India and Pakistan, the existence of a consortium has resulted in these countries receiving a somewhat larger volume of aid than they would have done otherwise. This is because the donor countries feel under some pressure to put up a good show when the effort of each is subject to critical examination by the others -- and because an element of teamwork is involved in seeking what is accepted as a common objective. On a number of occasions in the Indian consortium there has been a certain amount of bargaining between the members, led by the United States which as much the largest donor has consistently and on the whole successfully

exerted pressure on the other member countries to "up" their contributions.

While the Indian and Pakistan consortia have been concerned to see that the total amounts of aid extended to these two countries come reasonably close to matching their requirements and absorptive capacities, increasing emphasis has been laid on improving the terms of aid. Here again the United States has taken the lead with the full support of the Bank, and the progress made though less than might have been hoped, has been considerable.

Six years ago, when the consortium first met, India was financing a sizeable part of her development by means of medium-term suppliers credits. The use of such credits has since been much reduced, and instead of credits of five years or less the normal pattern set by the consortium is a minimum repayment period of 10-12 years -- usually 10 years from the time of delivery.

It is interesting to note that private lending to India has begun to adjust itself to this pattern. Recently, for instance, two private banks in the United States -- the First National City Bank of New York and the Continental Illinois National Bank and Trust Company -- agreed to extend 15-year loans to help finance a government oil refinery at Cochin in Southern India. These loans were guaranteed by the Phillips Petroleum Company, which is associated with the Indian Government in this venture.

There has also been some progress in the direction of a reduction of interest rates, but the consortia are still a long way from reaching the point where it can be said that the terms of aid to India and Pakistan take adequate recognition of these countries' limited capacities to service external debt. The average rate of interest charged on last year's consortium pledges to India was about 2-3/4 percent, but this average is heavily weighted by the contributions from the United States Agency for International Development and the International Development Association, both of which were then charging only

a nominal service fee of $3/4$ percent.

For the other consortium members the average interest rate was about 5 percent which is much too high -- although below what either India or Pakistan would have to pay if they were to seek to borrow in private capital markets. Canada is the only country which is extending aid through the consortia in the form of straightforward gifts.

The rate of interest which a borrowing country can in any real sense afford to pay over a long period will depend essentially on the returns to capital in that country and on the plough-back of profits into new investment. No country can afford to finance its development program through loans on conventional terms unless the returns to capital are in excess of the international lending rate.

Moreover, if a developing country is to become independent of external support, it must achieve a rate of domestic savings which matches the investment required to sustain an adequate rate of growth. Indeed, there must ultimately be a surplus of domestic savings over investment if external debt is to be repaid.

Few of the developing countries are yet in sight of fulfilling these conditions, and it is therefore essential that they should receive as much official aid as possible on soft terms -- ideally in the form of grants. This will certainly be in the interests also of exporters to such countries. A sizeable portion -- in some cases 20 percent or more -- of the foreign exchange earnings of the developing countries is already pre-empted for the service of external debt, and this severely constricts the purchasing power available for spending on imports. It also makes their imports extremely sensitive to fluctuations in their own export earnings.

To take India as an example, she will probably be repaying as much as \$1,300 million during the Third Five-Year Plan as interest and amortization on foreign loans. This is equivalent to about one quarter of what she can expect to receive during this period on a disbursement basis. The position during her Fourth Plan will be very much worse, and if she is to meet the repayments due on past loans, the gross amount of aid she receives will have to substantially increase. If much of this aid continues to be extended on a loan basis at near-conventional rates of interest, the debt service problem will get progressively worse as the total debt burden mounts.

In addition to stressing the importance of softer aid terms, the consortia have been exercised to find ways of encouraging private foreign investors to play an increasing role in assisting the developing countries to obtain capital -- and, just as important, to obtain the business management and know-how which are among the most critical factors in the process of industrialisation. As I have said, the existence of a consortium does in itself offer the private investor a greater sense of security while the consortium is in a position to act as an advocate for the cause of private foreign investment.

Private enterprise should also benefit from the trend in the Indian, and to a lesser extent also the Pakistan, consortium towards more non-project lending. While project lending has certain obvious merits, it also has drawbacks. For one thing, aid tied to specific projects is liable to encourage large and capital-intensive industrial projects which are usually in the public sector, whereas the requirements of private industry for imported capital equipment, materials and components are often difficult to fit into a project framework, particularly where a large number of fairly small firms are involved. It is largely to meet the needs of private industry for "maintenance imports" that the members of the consortium have agreed that something like half of this year's aid to India should be in non-project form.

Technical assistance has not so far featured very prominently in consortium discussions. There has, however, been growing recognition of the limitations imposed upon development assistance by organizational weaknesses and the dearth of specialized skills in the recipient countries. The World Bank and the International Development Association are both spending a good deal of time and money on the job of helping member countries with development programming and project preparation, and other members of the various consortia have also had to give attention to this problem in connection with their own lending activities.

Finally, I would say that the coordination of aid through a consortium has helped to mitigate the disadvantages that result from most governmental aid being tied to sources of supply in the aid-giving country. It has made it easier for the recipient country to shop around the different consortium countries so as to get the most advantageous terms for any particular contract and has reduced the risk of suppliers quoting excessive prices, which is liable to happen when these have no fear of foreign competition.

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This may not appear to be a very inspiring record of achievement. But there is no magic in a consortium. The idea that a country has only to get a consortium formed for it to solve all its problems is entirely illusory.

Bilateral aid programs for India and Pakistan were already in existence before the consortia were formed, and these two countries could anyhow have expected an increasing flow of external assistance as their development programs got underway and as their own foreign exchange reserves were depleted.

It is sometimes suggested that the India and Pakistan consortia should intervene more directly in the administration of aid and use the collective bargaining power of their members to enforce upon the recipient countries such changes in economic policies and programs as may be considered necessary to secure the most effective utilization of aid.

There are two principal reasons why the consortia have not gone very far in this direction. One is the understandable objections on the part of the recipient countries to what they would consider ganging up of their creditors against them. Most of the consortium members individually impose some sort of conditions on the use of their aid, as indeed they should if they are to be able to assure their tax-payers, who put up most of the money, that the aid will be effectively used to promote development. The borrowing countries recognize that this is reasonable in principle, though they may object to particular conditions. They would consider it much less reasonable for the consortium to present them with collective demands.

Anyhow, there is the other difficulty that there is no clear consensus amongst the members of the consortia as to the policies and programs which the developing countries should pursue, and as to the kind of conditions which should be attached to consortium aid pledges.

This has become particularly evident when the merits of individual projects have been discussed -- for example, the Indian nuclear power program. The Bank and other independent observers have expressed considerable doubts about the economic justification for this program. On the other hand, contracting firms in a number of the consortia countries have not unnaturally been anxious to secure orders for any nuclear power plants that may be established. In the event, both the United States and Canadian Governments are now assisting the establishment of nuclear power stations in India.

In conclusion, I would say that the international consortium is an organism that has developed naturally in response to the need for a concerted effort on the part of the advanced industrial countries to assist in raising production and income in the poorer countries of the world. Its future evolution -- and that of other organizations such as the Development Assistance Committee of the OECD -- will depend on the foreign aid policies of the United States, Canada, Western Europe and Japan.

Already between one quarter and one fifth of the total flow of international aid falls within the ambit of the consortia and consultative groups organized by the World Bank and the OECD. But it is not presently envisaged that the number of consortia will be greatly enlarged. Indeed, the usefulness of a special arrangement of this kind would appear to be subject to the law of diminishing returns.

There will still be need for close consultation and cooperation between the aid-giving countries on the general policies to be followed with regard to the allocation of external assistance and with regard to the terms on which such assistance shall be made available. In this field all the permanent international institutions have important and continuing roles to play. There are the World Bank, together with its affiliates, the International Development Association and the International Finance Corporation. There is the International Monetary Fund. There is the OECD and the DAC. There is the Inter-American Development Bank. There is the United Nations itself, the United Nations Special Fund and the various Specialized Agencies. Now there is a proposal for a new organization to be set up to continue on a more permanent basis the work of the recent United Nations Conference on Trade and Development.

But we should not forget that, with the world organised as it is, the effective decisions on aid are taken at the national level and not by any international body. It is national governments which have to mobilise the resources for international aid programs, and it is the United States above all whose generosity and imagination have made possible the global campaign of economic development to which so much of the time of this conference has been devoted.

EP Wright
Sept 21/64